The Regulation of Money Service Business: A Consultation

September 2006

HM TREASURY

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HM Treasury contacts

This document can be found on the Treasury website at:

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For general enquiries about HM Treasury and its work, contact:

Correspondence and Enquiry Unit
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ

Tel: 020 7270 4558
Fax: 020 7270 4861
E-mail: public.enquiries@hm-treasury.gov.uk

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Preface

In 2001, the UK Government introduced a new supervisory regime for Money Service Businesses (MSBs)—and committed to reviewing the arrangements after a few years of operation. This exercise is now underway.

This consultation paper has been issued to allow stakeholders in the MSB sector to inform the review's work.

It sets out the key questions to be addressed in deciding how best to build on the 2001 regime and respond to recent agreements in the European Union on anti-money laundering measures.

The Government welcomes views on this paper's assessment of the current regime, proposals for change, and responses to the questions posed, by 6 December 2006.

Please see the section entitled "How to Respond", in Chapter Eleven, for instructions on how to respond to this consultation document.

2 Executive Summary

2.1 In 2001, the UK Government established a supervisory regime for the Money Service Business (MSB) sector to combat money laundering and terrorist finance. Appropriately for a new regulatory system in a diverse sector, the new rules were kept deliberately light-touch, with the primary focus on education and outreach.

2.2 The Government also committed to review the implementation and enforcement of these rules in due course. Sufficient experience has now been built up to allow this to happen. At the same time, new EU legislation has emerged which will have specific implications for the MSB sector. The time is therefore right for a review of MSB regulation to be launched.

2.3 The government's objective is to promote a vibrant and competitive MSB sector that is properly protected from the risk of money laundering and terrorist financing purposes.

2.4 This consultation document considers a number of opportunities to make the current regime more expressly risk-based, so that it supports honest and legitimate businesses while better targeting those who abuse the system. This aim is firmly aligned with the Hampton Review's Better Regulation Principles (see Box 1), principles that have from the start been firmly embedded in this review.

2.5 Specifically, the consultation paper puts forward a package of proposals, the majority of which would have no new regulatory burden on the sector, but would have important implications for the regulator. The proposals are to:

- prevent criminal entry into the sector, and enable the extraction of criminal elements already in the sector by replacing the registration system with a licensing system. The new requirement on industry (required by the 3rd EC Money Laundering Directive) would be matched by a more explicit function within HMRC to identify and challenge unregistered operators (that is, 'police the perimeter');
- adopt a more risk-based and intelligence-led targeting of assurance and enforcement visits, with additional data collection by operators enabling risk assessment and thus heightened surveillance on highest-risk operators;
- specify in guidance HMRC's requirement for financial records to be provided on request in a consistent form and in English in order to establish actionable audit trails for investigators;
- strengthen the sector's compliance culture and improve compliance with existing and forthcoming money laundering and terrorist finance requirements through enhanced guidance for, and engagement with, the sector;
- establish a reinforced assurance and enforcement function, with HMRC robustly tackling serious or persistent non-compliance among MSBs including through prosecution.

2.6 Taken together, the proposals outlined above are also designed to:

- ensure the law is enforced and MSBs become active partners in the fight against crime and terrorism;
- improve the competition in the sector by levelling the playing field for the legitimate majority;
- improve the reputation of the sector, among consumers and financial service industry partners, supporting the continued strong growth of the sector; and
- provide additional protection for consumers.

2.7 The Government welcomes views on this paper's assessment of the current regime, proposals for change, and responses to the questions posed by 6 December 2006.

2.8 Annex A contains a partial regulatory impact assessment of the costs and benefits of these options. We would particularly welcome stakeholders views on this assessment of the costs and benefits of the options identified, and would appreciate feedback on any inaccuracies or omissions.

2.9 Finally, for respondents' convenience, annexes B-F contain details on current and forthcoming legislation affecting the sector, consultation criteria, contacts for comments and complaints, a list of stakeholders consulted, and a glossary explaining acronyms and technical language used.

3 Introduction

3.1 The MSB sector— comprising Money Transmitters, Bureaux de Change and Cheque Cashers— is a diverse but important part of the UK's financial services industry.

3.2 Like other areas of financial services, the government aims to ensure that the MSB sector is both highly competitive and properly safeguarded from abuse for money laundering and terrorist finance purposes.

3.3 With the introduction of the 2001 UK Money Laundering Regulations, the Government established a regulatory regime for the MSB sector to tackle money laundering and committed to reviewing its application to ensure that the UK's anti-money laundering and counterterrorist financing objectives are met.

3.4 The review—essentially of the implementation and enforcement of the regime established under the 2001 MLRs—is now underway. This consultation paper has been produced so that all stakeholders may have the opportunity to inform the conclusions of the review. It considers a number of opportunities and their potential to make the current regime more expressly risk-based, so that it supports honest and legitimate businesses while better targeting those who abuse the system.

3.5 This aim is in firm alignment with the Hampton Review's Better Regulation Principles (see Box 1), principles that have from the start been firmly embedded in this review.

Box 1: The Hampton Review Recommendations for Better Regulation

- Entrench the principle of risk assessment throughout the regulatory system, so that the burden of enforcement falls most on highest-risk businesses, and least on those with the best records of compliance;
- Ensure that inspection activity is better focused, reduced where possible but, if necessary, enhanced where there is good cause; at present, not only are unnecessary inspections carried out but necessary inspections are not carried out;
- Make much more use of advice, again applying the principle of risk assessment;
- Substantially reduce the need for form filling and other regulatory information requirements; and
- Apply tougher and more consistent penalties where these are deserved.

3.6 This review process is also an opportunity to take stock of the implications of key areas of EU legislation which will directly impact upon the MSB sector, in order to ensure that the MSB review—a review with wide implications in terms of implementation and enforcement for the sector—is properly joined-up with the EU-driven changes being made under the Payment Services Directive (PSD), the Third EC Money Laundering Directive, and the Payments Regulation.

3.7 This document provides a basic background on the MSB sector. It then outlines and assesses the current regime; identifies areas for potential improvement and then seeks industry views on a number of possible changes in the near future.

4 The MSB sector in the UK: key features

This chapter provides a brief background to MSB sector.

4.1 The MSB sector consists of:

- **Bureaux de Change**: which buy and sell foreign currency to retail and business customers, and issue and exchange travellers' cheques. Currency wholesalers are included in the definition. They may charge a fee and make a profit on the exchange rate.
- **Money Transmitters**: which transfer money from one location to another without physically moving the cash. The transfer is usually to an overseas location using a variety of methods including wire transfers, telephone and fax, bank transfers and offsetting liabilities. A fee is charged for the transfer and profit made on currency exchange.
- **Cheque Cashers**: which cash cheques made payable to their customers by third parties. They charge a commission for cashing the cheque and accept the risk that the third party might not honour the cheque.

4.2 The category "money transmitters" is particularly diverse—ranging from large organisations like Western Union, to what are often termed "informal value transfer systems" (IVTS). These systems are often deeply rooted in historical, cultural and economic backgrounds. Well known examples include "hawala", "flying money" systems indigenous to China, India's "Hundi" system, and the "padala" system used in the Philippines .

The MSB market in the UK

4.3 There are currently over 3,200 MSB principals in the UK, operating out of over 32,000 premises. 66% of these premises are operated by three MSBs (Post Office Ltd, Moneygram International Ltd and Fexco Money Transfer Ltd). Despite this high level of consolidation in the MSB market, the number of single-premises principals has risen strongly since July 2004, growing by 24%. The fast growth of these single-premises principals suggests that the market is competitive and that the barriers to entry into the MSB market for small businesses are low.

4.4 In order to illustrate the split between different kinds of MSB activity, the table below shows the breakdown of MSB premises by the business activities undertaken at each premises (as opposed to the activity of their principal) as of 2nd September 2005.

4.5 In terms of geographic location, MSB premises are located predominantly in England, where they are distributed fairly evenly, but with an exceptional concentration in London.

The role of remittances

4.6 The money transmission business is of great importance in facilitating remittances from migrant workers, particularly to the developing world. Money sent home by migrant communities living in high- and middle-income countries is the second largest financial inflow to developing countries behind foreign direct investment, exceeding even international aid.

4.7 The MSB sector is a significant enabler of effective development finance, through remittances via formal channels, which will encourage financial inclusion for low income people.

Table A: MSBs by business activity

Business Type	Number of Premises	Percentage Premises
BdC/CC	534	1.6%
Money Transmitter (MT)	9767	30.3%
Bureau De Change (Bdc)	4276	13.3%
BdC/MT/CC	15465	48.1%
Cheque Casher (CC)	1371	4.2%
BdC/MT	407	1.2%
MT/CC	311	0.9%
TOTAL	**32131**	**100%**

4.8 Estimates for total remittances sent from the UK to developing countries range from £463 million to £2.8 billion, with the most reliable estimate being £2.3 billion (for 2001). This represents a tiny proportion of UK GDP (0.23%), but over three quarters (78%) of the total for official UK Overseas Development Assistance to developing country recipients like India, Pakistan, the Caribbean (particularly Jamaica), China, Bangladesh, Nigeria and Ghana.

4.9 The MSB sector, then, is a significant and valuable part of the UK financial services sector's contribution to development. It is critical therefore that regulator keeps the sector clean in an effective and risk based way.

5 Overview of the current regime

This chapter provides a brief outline of the structure of the current regulatory regime for the MSB sector, providing basic details about the registration requirements, guidance, and assurance and enforcement measures.

5.1 All MSBs are required to comply with the UK's Money Laundering Regulations (MLRs). These contain a number of requirements for the regulated sector (including MSBs) including:

- implementation of proper systems and controls to prevent money laundering;
- appointment of a nominated officer (often referred to as a Money Laundering Reporting Officer);
- staff training;
- 'Know Your Customer' (KYC) and recordkeeping requirements.

5.2 More details on these requirements can be found in Annex C. The Regulations provide a critical role in disincentivising crime, aiding the detection and prosecution of crime, and safeguarding the integrity of the financial system (Box 2).

Box 2: Objectives of the UK Money Laundering Regime

- To provide a disincentive to crime by reducing its profitability and the pool of money available to finance future criminal activity. Robust systems of controls to detect, intercept and confiscate criminal funds make it harder for individuals or groups to profit from their criminality and to fund their next crime.
- To aid the detection and prosecution of crime. The intelligence provided from money laundering controls may provide leads which can be crucial in convicting criminals of money laundering and/or the underlying predicate offence.
- To protect the integrity of the financial system and reputation of UK business. The competitive position of UK business depends upon its reputation for integrity and honest dealing.
- To avoid economic and competitive distortions. Legitimate businesses are disadvantaged when competing against businesses controlled by criminals who may be willing to accept lower rates of return or even losses to maintain the appearance of being legitimate investments.

5.3 Following the introduction of the 2001 MLRs, Her Majesty's Customs and Excise (now HMRC) were given new responsibilities for the supervision of the MSB sector in order to:

- provide MSBs with assistance in meeting their obligations under the 1993 MLRs;
- detect and disrupt the abuse of MSBs for money laundering and—in the aftermath of the events of 9/11—terrorist financing; and to deter future abuse of the sector for these purposes through:
  - the dissuasion of criminal elements from entering the market;
  - a hardening of the environment for those who wish to abuse the sector; and
  - the provision of a credible threat that compliance will be enforced, and abuse punished.

5.4 The approach taken to meet these objectives was explicitly 'light touch', in line with the principle of "starting low" - and only gently increasing regulation if it later proves necessary. Equally, in a sector that was particularly new to regulation, it was important to build relations with business through communication and outreach in order to manage the risk of driving business underground .

Registration

5.5 All MSBs, other than those already regulated by the Financial Services Authority (FSA) for the conduct of other financial service business, are required to register with HMRC.

5.6 Applicants are required to provide sufficient information concerning business activity in order to allow HMRC to maintain a register that will effectively support their supervisory activities. Such information, provided by traders through the completion of a questionnaire, includes the following:

- name of the business and address of each set of premises undertaking MSB activity;
- name and address of each agent or franchisee, all those who control the business, and the nominated officer/Money Laundering Reporting Office (MLRO);
- type of business operated;
- statement of whether any of the Directors or managers of the business hold a conviction for any offence under the MLRs;
- notification of any changes to the above.

5.7 An annual registration fee funds part of the cost of administering the regime. The current fee is £60 for each set of premises operated by the MSB. Some larger MSBs act as a principal, conducting business through a network of agents. In these circumstances, HMRC currently treat the principal as responsible for paying the fee for their agents' premises.

Supervision

5.8 Building on the register of MSBs, HMRC's supervisory role consists of three distinct areas: guidance/education; compliance and enforcement.

5.9 Guidance: HMRC issue a package of guidance whenever an enquiry about registration is received. The package comprises a well-received educational video and two public notices explaining to MSBs their obligations under the Money Laundering Regulations. An overview of the guidance available is also set out on the HMRC website. All this material is geared towards helping the sector interpret the Regulations in an easily digestible form. More details can be found at www.hmrc.gov.uk

5.10 Assurance: HMRC assurance officers visit registered MSBs to ensure that they are aware of their responsibilities under the Money Laundering Regulations and are complying with them. Since June 2002, every MSB principal, as well as a number of agents, has been visited at least once—and those traders with 40 branches or more also receive ongoing monitoring by a designated officer via the business Head Office.

5.11 Assurance officers examine the records and anti-money laundering systems of the traders they visit, and so are well placed to give tailored advice and guidance on requirements, particularly where AML systems are found to be falling short of compliance.

5.12 Enforcement: Via the Revenue and Customs Prosecutions Office, HMRC have the power to prosecute (with up to two years imprisonment as penalty) and the power to serve fines of up to £5000 for each breach of the money laundering regulations. HMRC also has the power, under the Proceeds of Crime Act, to prosecute MSBs where they believe a money laundering offence has been committed—an offence which can carry up to 14 years imprisonment upon conviction.

5.13 HMRC have chosen to adopt a stepped approach to the application of these sanctions. Typically, a warning letter is issued when a breach of the regulations is identified. Should a follow-up visit find continued non-compliance, then HMRC issue either a second warning letter or a fine. Now that the regime has had time to settle down, HMRC will be increasingly issuing fines after only one warning letter.

6 Money laundering risks in the current regime

This chapter will provide a practical assessment of the current regime. Case studies are provided to illustrate how the sector can, and is, being exploited for financial criminal purposes.

6.1 The first phase of MSB regulation has been designed from a "start low" principle, in an effort to ensure that only the minimum necessary level of regulation would be imposed on a sector.

6.2 A successful regime must, however, go as far as it can in support of honest and legitimate businesses whilst better targeting those who abuse the system. A successful money laundering regime for MSBs must tackle four possible kinds of abuse:

- legitimate and compliant MSBs, which are unwittingly exploited by organised crime;
- legitimate MSBs which are non-compliant or 'wilfully blind' to the activities of money launderers exploiting their services;
- legitimate MSBs which are complicit in the supply of services to organised crime or are exploited by means of corruption;
- ostensibly legitimate MSBs which are wholly owned and exploited by organised criminals.

6.3 Case studies to illustrate how these four categories can be, and have been, exploited are set out below. These are not indicative of the general nature of the whole MSB sector but rather as illustrations of the range of ways that MSBs can be vulnerable to abuse.

Legitimate and compliant MSBs that are unwittingly exploited by organised crime

6.4 MSBs—like the rest of the financial sector—are required, under the 2002 Proceeds of Crime Act (PoCA), to report any suspicious activity or transactions to the Serious Organised Crime Agency (SOCA)—and previously to the National Criminal Intelligence Service (NCIS) via the filing of Suspicious Activity Reports (SARs). The submission of SARs by innocent parties can reveal the unwitting exploitation of MSBs by organised criminals, as illustrated by the following two examples.

6.5 One firm that provides wire transmittance services to members of the public has a de minimis limit. This is a limit above which customer identification must be verified, and below which a risk-assessment is made before deciding whether or not verification is required. The firm has detected a significant pattern of "smurfing"—the splitting of large amounts of money into smaller batches in an attempt (unsuccessful in this case) to evade detection.

6.6 Another MSB provides wire transmission facilities for businesses. A previous assessment by the National Criminal Intelligence Service (NCIS) revealed this innocent party had repeatedly disclosed SARs against a group of businesses that, between them, were requesting that £10 million be transmitted to Colombia over a six month period. The owners of the businesses were subsequently arrested and charged with money laundering offences.

Legitimate MSBs that are non-compliant and/or 'wilfully blind' to the activities of money launderers exploiting their services

6.7 There is a fine distinction between MSBs that are inherently non-compliant or accept suspicious transactions without question—done to gain a competitive advantage over rival MSBs—and those that are deliberately complicit in a money laundering scheme.

6.8 There is evidence from law enforcement operations that criminal groups sometimes seek to strike up business relationships with MSBs, particularly bureaux-de-change, that are willing to take a permissive approach to money laundering rules. For example, a bureau-de-change raided in 2002 was found to have copious identity documents for its customers, some of whom had provided different passports with the same photograph. Despite conducting a large of amount of highly dubious business, the bureau had never chosen to disclose a SAR to NCIS.

6.9 Like the rest of the MSB sector, IVTS operations can be exploited by organised crime. Criminals are attracted to those IVTS traders that are not compliant with the recordkeeping requirements set upon them by the MLRs. Traders that keep minimal or no records are particularly attractive for those seeking to ensure anonymity and the lack of a paper trail.

6.10 One investigation revealed a Spanish-based specialist money laundering group that was in contact with UK drug traffickers based in Southern Spain. The drug traffickers had sterling in the UK and required the equivalent amount in Euros in Spain. The specialist launderer instructed an associate in the UK to collect the sterling from associates of the drugs traffickers. The cash was consolidated in London, and handed to the IVTS operators. As soon as the IVTS operators received the cash, Euros were paid out in Barcelona, where they were collected by another member of the network and physically transported either by air or road to Southern Spain and distributed to the drugs traffickers.

Legitimate MSBs that are complicit in the supply of services to organised crime or are exploited by means of corruption

6.11 A step beyond those MSBs willing to "turn a blind eye" to suspicious transactions are the small minority of MSBs that are complicit with organised criminals.

6.12 For example, one law enforcement operation revealed a major crime network which evaded detection by laundering proceeds through an associate. The associate was the owner of a registered cheque cashing company, the accounts of which revealed a turnover of nearly £10m during a six month period—an extraordinary turnover for a small business in a sector where small traders generally average less than £1m turnover per annum.

Ostensibly legitimate MSBs that are wholly owned and exploited by organised criminals.

6.13 One long-term HMRC (at the time HMC&E) investigation provides a good example of the deliberate abuse of an illegitimate bureau for money laundering purposes. The operation began when the Colombian directors of two bureaux-de-change and their associates were observed paying in large amounts of cash at high street banks. The investigation established that cash deposits were made up to three times a day into the business bank accounts of the bureaux. Occasionally one person would make three or four deposits at the same time, each represented by a separate credit slip. Each separate transaction was less than £10, 0000, in the erroneous belief that the banks would not report such transactions as suspicious.

6.14 The investigation also established that illicit "street" cash was co-mingled in the accounts of the bureaux with cash obtained in the course of the ostensibly legitimate exchange business. Once grown to a satisfactory level the sterling was transferred to US dollar accounts operated at the same banks. A day or so later the US dollars were telegraphically transferred to accounts in Miami and around the world. The principals of the two bureaux were also observed at meetings with a number of other suspects. Bags, believed to contain large quantities of sterling street cash, were exchanged on a number of occasions between these parties.

6.15 Subsequently, these bags were taken to another four "dishonest" bureaux-de-change in order to launder the cash by exchanging it into the US$ high denomination notes. A search of the NCIS database revealed that no suspicious transactions were disclosed by any of these bureaux. It is estimated that the organised crime group behind the operation of the two bureaux laundered some $70 million.

ASSESSING MONEY LAUNDERING IN THE MSB SECTOR

6.16 These case studies are illustrative and not indicative of the general nature of the sector. They do, however, give a taste of just some of the ways that organised criminals are finding to exploit and abuse the sector. They also usefully show the distinction between those MSBs who are non-compliant through ignorance, and those who are wilfully non-compliant.

6.17 There are, however, more general indications of the level of compliance with money laundering requirements and the vulnerability of the MSB sector to financial crime. Some conclusions can be drawn from the percentage of money laundering cases investigated since the Regulations were introduced.

Significance of MSBs in money laundering investigations

6.18 Between June 2002 and October 2005 there were a total of 246 Money Laundering Investigations by HMRC. Of these, around 1/5 of all HMRC money laundering investigations directly involve an MSB.

6.19 A review of current flagged money laundering operations in the SOCA's database of Suspicious Activity Reports identified that 19% of the total featured the exploitation of MSBs.

6.20 For both SOCA and HMRC activity, therefore, about 1 in 5 money laundering investigations feature the exploitation of MSBs.

Levels of compliance in the MSB sector

6.21 A survey of all assurance visits conducted by HMRC between April-September 2005 found that 45 per cent of MSBs visited by HMRC were judged non-compliant for failure to implement one or more of the following basic requirements of proper money laundering controls:

- Know Your Customer measures in place;
- Money Laundering Reporting Officer (MLRO) nominated;
- Staff training;
- Systems and controls to prevent money laundering;
- Recordkeeping for at least five years after the end of the business relationship.

6.22 Furthermore, 6 per cent of traders were judged to be seriously non-compliant. In these cases, traders were fully aware of the requirements on them and had decided against implementing the systems and procedures to comply.

Compliance with MLRs: reporting suspicious activity

6.23 In addition to the non-compliance detected through the inspections programme, a comparatively high level of non-compliance is also indicated by the fact that disclosures of suspicious activity by MSBs have been dropping significantly in absolute numbers over the last few years, against a trend of significantly increasing numbers of SARs from all disclosing institutions (40% growth over 2004/05).

6.24 Such a drop in reporting would be expected if there was reason to believe that suspicious activity in the sector was itself dropping. This is, however, extremely unlikely as one third of all SARs received by NCIS on businesses have been reporting the suspicious activity of MSBs.

6.25 Given the many different ways in which investigation and intelligence have revealed that organised crime can, and is, exploiting MSBs, and in light of the sector's vulnerability due to poor levels of compliance, it can be concluded that the time is right to further develop the regulatory regime for MSBs.

6.26 The "minimum necessary" level of enforcement and supervision, designed for the first phase of supervision, is no longer sufficient to protect honest and legitimate businesses whilst effectively targeting those who abuse the system.

6.27 As long as sufficiently robust safeguards to prevent money laundering are lacking in the MSB sector, opportunities remain for terrorist financing and organised criminal exploitation to continue damaging the sector's reputation, fair competition, and the UK economy.

7 Structural assessment of the current regime

This chapter assesses key features of the existing regulatory regime for MSBs and points to possible areas for reform.

7.1 The regulatory regime for the MSB sector should evolve in the same way as other areas of financial services in the UK – by becoming more risk-based, intelligence-led, targeted and proportionate. This section explores the scope to develop these principles in key parts of the current system.

Registration

7.2 All regulation involves some kind of 'gatekeeping' function on the part of the regulator. Current arrangements for MSBs involve a simple registration requirement which then underpins the outreach programmes that figure prominently in HMRC's approach to regulation. This outreach focus has its advantages, but there are also limitations in this approach which could affect the ability to root out wrongdoing in a targeted way.

7.3 Unlike other parts of the financial sector, there are currently no means of refusing registration to applicants who are not judged to be of sufficient honesty, integrity, reputation, competence or capability to undertake their money laundering obligations. Currently, even those with a long history of money laundering cannot be refused entry into the market.

7.4 Second, there is no mechanism for de-registration of MSB traders who, once registered, prove themselves to be of insufficient honesty, integrity, reputation, competence or capability to undertake their MLR obligations.

7.5 Finally, there is currently no formal strategy for "policing the perimeter" of the regime – that is, to make sure that all operators in the sector are registered and are therefore subject to HMRC supervision. Generally, except where these operators are detected in the process of HMRC investigation activities, the current regime leaves this problem unaddressed.

Guidance

7.6 Guidance plays an important role in promoting MSB awareness of their legal obligations.

7.7 As discussed in chapter four, there are notably high levels of non-compliance in this sector. A proportion of this non-compliance is likely to be the result of poor or patchy awareness of legal obligations, indicating that there is room to build on existing guidance outreach efforts. Indeed, many MSBs have indicated that this is something they would find helpful.

Assurance and Enforcement

7.8 Outreach and communication is important in so far as it relates to those MSBs which are non-compliant through ignorance rather than will. Wilful non-compliance and direct abuse of the sector, however, needs to be tackled through deterrence created by the credible threat of detection and disruption, including through prosecution.

7.9 There are a number of areas of current practice that could be helpfully be strengthened in order to provide such a credible threat.

Assurance Visits

7.10 First, the role of assurance officer has been designed in a way that excludes the pro-active probing of a trader where suspicions are raised on assurance visits—for example, assurance officers do not currently question the credibility of businesses' commercial viability, trading level and declared profits when conducting visits.

7.11 Second, the assurance visits programme could devote additional attention to operators flagged as higher risk. Conversely, there is an option to develop a stepped-down version of assurance monitoring that could be made available to those identified as particularly low risk. At present, the programme is not yet configured to focus resources on the highest risks.

Investigations

7.12 Money laundering investigations must follow complex financial trails. Investigations can be hampered if an MSB keeps only incomplete or insufficient records, or where these are kept in a language other than English. In such cases, it can impossible to construct meaningful audit trails, undermining the credible threat of detection and disruption.

Non-Compliance and Enforcement

7.13 An examination of assurance and enforcement activities reveals a gap in the "compliance continuum": the evidence on money laundering in the MSB sector suggests that the assurance programme has not in itself led to the perception across the system that that risk of detection is high and that there is a persuasive threat of sanctions. There is therefore greater scope to proactively target the small minority of permissive, or wilfully non-compliant, MSBs.

7.14 This situation could lead to the belief among some MSBs that it is possible to turn a blind eye to suspicious activity (to perhaps gain a competitive advantage) and remain undetected and unpunished.

Summary

7.15 An assessment of the supervisory regime, and its role in providing a preventative safeguard against money laundering, suggests that there is a need to further dissuade criminal entry into the market; build on the risk-based approach to supervision to support more intensive action against non-compliant MSBs; and encourage greater policing of the perimeter to crack down on the illegal MSBs who pose unfair competition to those registered.

8 Options: registration

This chapter outlines the options for alterations to the registration component of the regime. Movement towards licensing through fit and proper tests, a mechanism for trader deregistration, and an explicit policy of policing the perimeter, are the principal options considered.

Registration or Licensing: a spectrum of options

8.1 There are broadly two approaches to defining the group of firms regulated in any regime. One—registration—is by definition inclusive: operators need only add their name to the supervisor's list of firms in order to conduct their business. The other approach is licensing, which implies that a supervisory body has inspected and sanctioned the particular operator to conduct its business, based on the fact that the operator has met the standards or criteria set for it.

8.2 The current regime operates a registration system, which carries with it the advantages of: minimal barriers to entry, regulator confidence that the majority of operators are listed, and consequently, a reduced need to "police the perimeter" of the regime to make sure that there are no unregistered operators.

8.3 However, these advantages must be weighed against the disadvantages set out in Chapter 7. To meet this challenge, the Third EU Money Laundering Directive will require (by the end of 2007) the establishment of "fit and proper tests" for this sector in the UK. This will require a distinct move away from the current registration regime towards a licensing approach. In this case, the standard for inclusion in the regime will be the passing of a fit and proper test.

8.4 A licensing approach brings along with it benefits, particularly in terms of the prevention of criminals from obtaining a controlling interest in MSBs and a general hardening of the environment for financial criminals. As a result of the 3rd Money Laundering Directive, HMRC will have the power to refuse a licence to those who fail the test, but they will also have the power to remove traders' licences where they have proven themselves to be unfit and improper after the fact.

8.5 The key question is what level of exclusivity the licensing regime should have. That is, what criteria should MLROs, Directors, beneficial owners, or controllers have to meet in order to be granted a licence for operation in the UK?

8.6 An example checklist of criteria that could be considered for a UK fit and proper test for the sector would include:

- No convictions for money laundering offences, PoCA or Terrorism Act offences, fraud or other financial criminal offences;
- No convictions for immigration, drug trafficking and HMRC offences;
- No undischarged bankruptcy, Individual Voluntary Arrangements (IVAs) or County Court Judgements (CCJs);
- No disqualification from acting as a company director or acting in a managerial capacity;
- No history of directorship of a liquidated company;

- No confiscation or restraint orders;
- No consistent failure to comply with the requirements of the MLRs.

8.7 There is also the question of whether a positive match against law enforcement databases should be considered to be sufficient grounds on which to withhold a licence.

8.8 The Government is keen to solicit views on the appropriate criteria to be used in such a test. In particular, there is a question as to how far a "check-list" approach would provide stronger reassurances as to the integrity of the operator in a way that enhances its reputation.

8.9 An alternative to the above approach would be to introduce a license based on "positive" criteria, as happens in a number of other countries—for example:

- Czech Republic requires particular professional qualifications to be held by applicants;
- Germany requires the submission of a business plan and a commitment to annual external audits;
- Spain insists that applicants demonstrate that they have the necessary internal structures and procedures to detect illicit operations;
- Japan requires positive business forecasting and details of personnel structure; and
- Belgium requires that managers have "sufficient experience" in the sector.

8.10 Ireland's fit and proper test is a good example of a holistic assessment of applicants' suitability for entry into the MSB sector. The key requirements of the Irish fit and proper test have been included in Annex D for information. The Irish test contains within it negative criteria relating to criminal history and the like—but the ultimate assessment is informed by wider supporting information, such as character and business references, enabling a more informed assessment of propriety and standing.

8.11 In general, a more holistic approach to "fit and proper test" will have greater scope for more rounded judgements to be made by the regulator and for stronger reassurances to be given about those individuals occupying positions of influence in firms. The more holistic approach could also reduce the risk of unsuitable applicants entering the sector if their particular reason for unsuitability fell outside the narrow criteria for yes/no decisions.

8.12 The possibilities for a UK "fit and proper test" therefore range from fairly basic negative criteria to be met, to criteria that make up a more holistic, encompassing assessment of applicants.

8.13 The principal disadvantage with both approaches will be cost—traders essentially fund the operation of the MSB regime; any increase in costs of regime operation (including fit and proper test administration) will be borne by traders.

8.14 On balance, the government's initial inclination is to opt for an approach based on 'negative criteria', on the grounds that some formulation of it should be able to meet the objectives of the 3rd Directive in the most proportionate way. The government welcomes the views of stakeholders on this point.

Questions:

- How should the government ensure the judgement of an operator's suitability to hold a license is kept up-to-date? Should there be an annual declaration of any breaches? Or declarations on an "as it happens" basis as required by the FSA for its relevant sectors?
- Are there any positive or negative criteria not featured here that would be particularly suitable for application in a UK "fit and proper" test for MSBs?
- Would the optimal configuration of a fit and proper test be one made of negative criteria, positive criteria, or a mix of both?
- What benefits do MSBs envisage the fit and proper tests delivering for the sector in terms of money laundering reputation?
- There are indications that some MSBs have had difficulty obtaining a bank account due to a perception that MSBs have poor AML processes and systems; do traders believe that a more holistic fit and proper test may improve this situation?

Policing the Perimeter

8.15 In order to support the vast majority of honest and legitimate MSBs, there should be robust policing of the perimeter to root-out unlicensed operators. This is the natural corrolary of any fit and proper test—as without these measures robust policing the perimeter measures those traders refused a license might otherwise move underground.

8.16 In order to support the identification of unlicensed activity, the government is minded, as a basic first step, to make a list of licensed MSBs publicly available.

8.17 In addition, the FATF has published a number of recommended identification strategies to assist in the development of a strong 'perimeter' in this sector:

- Examining the full range of media to detect advertising conducted by MSBs, such as local and community newspapers and the Internet;
- The encouragement of enforcement agencies to use undercover techniques or other specific investigative techniques to detect MSBs services that may be operating illegally;
- Consulting with the operators of registered / licensed MSBs for potential leads on MSBs that are unregistered or unlicensed—it is, after all, in their interest to prevent operators gaining a competitive advantage by operating outside the law;
- Being aware that MSBs are often utilised where there is bulk currency moved internationally, particularly when couriers are involved. Couriers, particularly those found to be involved in illicit activity, could provide insights for the identification and potential prosecution of any unregistered MSB operators with whom they may be associated;
- Assisting banks and other financial institutions in developing an understanding of what activities/indicators are suggestive of MSB operations and using this to identify where an MSB has not declared this activity.

8.18 Though we are not formally consulting on changes to policing the perimeter policies, we would like to elicit views on where additional attention would most effectively identify unlicensed activity, and whether there are any important means of policing the perimeter not identified here.

Questions:

- Are there any other sources of information that could potentially reveal the operation of unregistered MSBs?
- Should there be a contact number for MSBs reporting the operation of a suspected unregistered MSB?
- Where are unregistered MSBs most likely to advertise their services?
- If the register of licensed operators was published, would traders crosscheck the names of those with whom they are conducting business? If not, should there be a requirement to ensure that crosschecking is done?
- What sanctions should be applied to penalise those found to be operating without a license?

9 OPTIONS: GUIDANCE

> This chapter examines the options for improving guidance to MSBs. The options considered include a focus on areas of poorest awareness, a more collaborative approach with the sector in the writing of anti-money laundering and counterterrorist financing guidance, and a commitment to keeping guidance up-to-date with new and forthcoming legislation affecting the sector.

9.1 Besides operating and policing of the registration scheme, another important remit for the regulator is the provision of information and education to the sector. In contrast with other financial sectors there are no industry-wide bodies performing this role for MSBs.

9.2 Some MSBs have made the case that the guidance currently available could be more practical and more forward-looking.

9.3 As argued in the Hampton Review , good guidance and advice can help reduce administrative burdens and increase probability of compliance. In particular, guidance can assist MSBs in their implementation of a proportionate and risk-based approach to the fulfilment of their anti-money laundering and counterterrorist financing obligations.

9.4 HMRC is currently working with MSBs in a thorough revision of the guidance. This work is particularly well timed to fit in with responses from this consultation document. Anyone wishing to contribute to the development of this guidance will be able to do so. To know more about this contact Paul Varley of HMRC on 0161 827 0904 or email paul.varley@hmrc.gsi.gov.uk

Assisting understanding and awareness of obligations

9.5 Some degree of non-compliance in the sector will undoubtedly be due to poor awareness of obligations. Particular areas where law enforcement believes awareness is patchy include:

- **International financial sanctions and asset freezes**. It is a criminal offence to make funds available to or for the benefit of individuals or organisations subject to financial sanctions or to a person acting on their behalf;
- **The obligation to report** - as indicated by the apparent decline in SARs reporting and the worryingly few “consents” sought by the sector. The reporting and consent requirements are explained in detail in Annex C;
- **“ Know Your Customer” measures**, which are instrumental in increasing the likelihood that suspicious activity will be detected and establishing an accountable audit trail. KYC is challenging in the MSB sector, as some business-customer relationships last no more than 30 seconds—making the availability of practical guidance particularly important. Additionally, the forthcoming Payments Regulation (see Annex B) will have significant implications for the KYC and SAR requirements upon MSBs.

Keeping up to date with UK and international legislation.

9.6 A particular challenge for HMRC guidance, and outreach work more generally, over the coming years will be ensuring prompt and sufficient depth of understanding of new legislation and requirements. For example:

- The 3rd Money Laundering Directive—to be implemented in the UK through new Money Laundering Regulations in December 2007—will bring with it a Fit and Proper test for the sector:
- The EU Regulation on Wire Transfers , coming into force in January 2007, will require all transfers remitted to destinations outside the EU to have the identification of the sender verified and originator information (name, address or date and place of birth, account number or unique identifier for non-account based transactions) to be sent along with the payment. Within the EU, verification documents will need to kept for 5 years and produced within 3 days upon request. More information on the requirements of the Regulation can be found in Annex B:
- Finally, the Payment Service Directive/New Legal Framework (NLF) is currently being negotiated in Europe and could have some significant implications for the money transmission sector, including a potential change in competent authority, and the possibility of prudential regulation and conduct of business requirements for the sector. Bureau de change and cheque cashers will be unaffected.

9.7 We welcome views from the sector on the following questions, and intend to use the answers we receive to improve the clarity and outreach of future guidance in those areas where awareness is poorest.

Questions:

- How helpful have you found the existing guidance?
- What aspects of the UK's anti-money laundering and counterterrorist finance requirements would the MSB sector find most helpfully set out in enhanced guidance?
- How would such guidance be best communicated?
- Does the sector agree that these are the areas of poorest awareness? In what way could HMRC
- assist in businesses adoption of a more risk-based approach?

10 OPTIONS: ASSURANCE AND ENFORCEMENT

This chapter examines options for improving the assurance and enforcement components of the regime. Principal options being considered include information requirements to enable robust risk-assessment, recordkeeping requirements to assist investigations, policing activities focused specifically on persistent non-compliance, and more robust sanctions to combat money laundering.

10.1 Non-compliance through poor awareness can be, to some extent, addressed through guidance and education. To tackle the wilful non-compliance and outright abuse of the sector, however, the compliance and enforcement regime supporting the regulation of MSBs needs to evolve into a robust, risk-based regime that identifies persistent non-compliance quickly, and enforces proportionate sanctions.

10.2 Options for improving assurance enforcement measures can be split into three categories: improving detection, improving disruption and improving deterrence.

Improving Detection

10.3 One possibility for improving detection is to increase the involvement of assurance officers in the process, through the performance of new credibility checking measures. It could become standard practice that assurance officers ask the following questions as part of their assurance visit:

- Is the business commercially viable?
- Are the business practices straightforward?
- Is the trading level comparable with similar businesses in the same location?
- Does the lifestyle of the owner accord with the declared profit?

Question:

- Are there any other obvious credibility checking measures that could be done—particularly measures that the sector would not feel are too invasive?

10.4 The government is also exploring whether there is scope for greater risk-assessment to help target the enforcement efforts of HMRC.

10.5 Whilst the Government acknowledges that businesses should not have to give unnecessary information, nor give the same piece of information twice, there is a strong argument that the current lack of business information on individual MSBs stands in the way of a more targeted approach by HMRC.

10.6 Initial suggestions of the types of information that would enable more thorough risk-assessment include: annual turnover; most frequent value of transactions; main customer type; most frequent type of transaction, estimate of future trading, top three destination countries, three main currencies transmitted, and source of customers' funds.

10.7 Initial assessment has revealed two mechanisms for the provision of the information above: data return and data collection and storage:

- **Data return**: this would require traders to send specified information to HMRC on an annual basis. This could take the form of an annual statistical return;

- **Data collection and storage**: this would involve traders keeping specified information on record for a time-limited period so that information can be collected during assurance visits by HMRC officers.

10.8 Alternatively, it may be that a **summary of business transactions**, akin to those traders are already required to produce for VAT purposes, could contain sufficient information for risk-assessment.

10.9 A "stepped-down" version of assurance visits could be created for traders deemed to be particularly low-risk—freeing up resources for focusing assurance and enforcement attention on the high-risk traders identified. As a result, there would be no net expansion of the inspections burden on traders; instead, resources would be targeted where they can deliver most: the highest risk-traders.

10.10 A stepped-down version of assurance visits does, however, need to be carefully designed to ensure that perceived scope for undetected non-compliance is not created. This could be done through:

- Assurance of continuing compliance delivered in the course of visits for other HMRC purposes—such as VAT or PAYE audits;

- Random visits and test purchasing to see that AML procedures are being properly implemented (where any system failures identified would inform the visits programme risk assessment of that firm).

Questions:

- Would a policy of stepped-down assurance visits carry too much risk?
- What is the relative ease/difficulty of acquiring the different types of information identified above as helpful for informing risk-assessment?
- Are there any other mechanisms for the acquisition of this information for risk-assessment?
- What would be the industry's concerns here?
- Are there any additional credibility checking questions that assurance officers should be asking?

Improving Disruption

10.11 As discussed in the previous chapter, money laundering investigations can be hampered by insufficient and incomplete information being recorded by MSB operators, particularly so if records are kept in a language other than English. Having records presented to authorities in English, and in a consistent form, will enable quicker and more effective disruption.

10.12 Regulation 15 of the MLRs states that "an MSB must furnish information relating to the business in such a form as may reasonably be specified". This gives HMRC the power to specify when requesting information that must be "complete, consistent and in English"; would therefore involve stating in guidance that MSBs must keep their records in English and in a specified format.

10.13 The government's preference is, rather than to mandate that MSBs keep records in English, for HMRC to specify the form in which they require information, upon request, to be provided—as this will require only a minor change to the guidance. It will, however, need to be backed up with a more consistent use by the regulator of sanctions for those who do not keep complete records (a requirement under the MLRs) and who do not provide information in English.

Questions:

- Is it correct to assume that because most data is/would be kept in numerical form, requiring MSBs transaction records to be kept in English would have only marginal additional costs?
- What would a proportional penalty be for failing to keep complete records?

Spotting non-compliance

10.14 Deterrence measures are the final area of assurance and enforcement that needs to be addressed. The fact that non-compliance (wilful and otherwise) has stayed steady at just under 50% since the start of the regime signals the need for there to be a more credible threat of identification and sanctions for those failing to comply with their legal obligations.

10.15 This could be underpinned through the use of dedicated compliance officers that explicitly target MSBs that are found to routinely fail to report suspicious activity or who otherwise persistently fail to comply with the money laundering regulations.

10.16 Swift identification and application of appropriate, credible sanctions to penalise non-compliance would also encourage a particular business to move into the compliant part of the sector promptly – building the compliance culture in the industry at large.

Sanctions for non-compliance

10.17 The issue of appropriate sanctions therefore needs to be considered. Options for change to penalties are currently being discussed, and so the objectives for such changes are discussed below in order to elicit industry views.

10.18 Current sanctions include civil fines of up to £5000 for each breach of the MLRs; criminal penalties following prosecution of 2 years imprisonment and/or an unlimited fine. Imprisonment can, however, be seen as a disproportionate response to some breaches; and no mechanism for deregistration as a sanction for non-compliance currently exists.

10.19 This makes financial penalties the most likely sanction for less serious breaches—however, as the Hampton Review points out , unless penalties levied take into account the economic value of the breach, it is often in a business's interest to pay the fine and continue with the competitive advantage of non-compliance. Moreover, unlike other sectors in the financial services industry, the reputational risk of receiving a fine from the regulator can arguably be more easily shrugged off by small traders.

10.20 Given this situation, there is a strong case for re-examining the range of options applied as sanctions for non-compliance. FSA regulated organisations founds to be in breach of the FSA Handbook Rules due to lack of appropriate AML systems and controls throughout the organisation are subject to significantly higher civil fines—often hundreds of thousands of pounds and sometimes millions. This sends a very strong message to the rest of the sector, driving up deterrence .

10.21 HMRC penalties should similarly send a strong message of deterrence to the MSB sector through the prompt application of proportionate sanctions.

10.22 In addition to the new penalty of removal of a license to operate in the sector (the fit and proper test) the government is considering changes to assurance and enforcement policy to support the application of more, and more proportionate, sanctions:

- improved detection of non-compliance, leading to an increase in number of civil and criminal penalties applied, until a deterrent effect improves compliance rates; and
- more proactive recourse to criminal prosecutions if and when appropriate;
- narrowing of the gap between the level of fines available for systemic money laundering failures by large FSA-regulated firms and large HMRC-regulated firms.

Question:

- Should there be a penalty points system for deregistration, similar to those for driving offences, whereby removal from the register would take place once a set number of points had been issued; or would this undermine the desired deterrent effect by enabling non-compliance for as long as MSBs remain just short of the maximum penalty point number?
- Should deregistration have a limited shelf life (like that of banned company directors) where re-registration could occur once certain criteria have been met? If so, what criteria should be used?
- Is it accurate to judge that, for some small traders, there is minimal reputational damage caused to some MSBs by fines for non- compliance?
- Are there any reasons why the level of fines available for systemic money laundering failures by large FSA- regulated firms should be any different for large HMRC-regulated firms?

10.23 Enforcement deters future non-compliance by the firm in question and, if there is sufficient awareness of enforcement action taken, the compliance culture across the industry can also be enhanced.

10.24 This translation of enforcement into deterrence can be seen in the FSA's publicity of their enforcement action against individual firms in the regulated sector. The FSA issues press releases to the sector in order to spread the news of the hefty fines issued to non-compliant firms (and their directors) by the regulator. This sends a strong signal to the sector regarding the FSA's commitment to dealing swiftly and robustly with non-compliance, thus creating a strong deterrent effect.

Question:

- How can HMRC best publicise its enforcement action against non-compliant MSBs?
- Besides spreading the word of enforcement action though the HMRC leaflet distributed to the sector, are there any other effective routes of communication that could be used for this purpose?
- How regular should the communication be?
- Would an annual publication be sufficient, or should there be monthly bulletins naming all newly deregistered MSBs and owners?

11 Conclusion and How to Respond

11.1 This paper sketches a package of proposals intended to make the current regime more expressly risk-based, so that it supports honest and legitimate businesses while better targeting those who abuse the system.

11.2 The principal options put forward aim to:

1. prevent criminal entry into the sector (and enable the extraction of criminal elements already in the sector) by replacing the registration system with a licensing system. The new requirement on industry (required by the 3rd EC Money Laundering Directive) would be matched by a more explicit function within HMRC to identify and challenge unregistered operators (that is, 'police the perimeter');

2. improve the speed and efficiency of criminal and terrorist financial investigations, as well as enabling timely arrests, prompt asset freezing, and successful prosecutions through:

   - a notably more risk-based and intelligence-led targeting of assurance and enforcement visits, with additional data collection by operators enabling risk assessment and so heightened surveillance on highest-risk operators;

   - the specification in guidance of HMRC's requirement for financial records to be provided on request in a consistent form, and in English to establish actionable audit trails for investigators;

3. strengthen the sector's compliance culture and improving compliance with money laundering and terrorist finance regulations through:

   - enhanced guidance for, and engagement with, the sector;

   - a reinforced assurance and enforcement function with HMRC robustly tackling persistent non-compliance among MSBs, including through prosecution and a wider range of civil penalties.

11.3 The objective of the review is to facilitate the evolution of the regulatory regime for MSBs in order to maintain an efficient, dynamic MSB sector that is properly safeguarded from the risk of money laundering and terrorist financing. By successfully managing these threats, the MSB sector can reduce the harm caused by serious crime and terrorism and help deliver:

- improved competition due to the levelling of the playing field for the legitimate majority;

- improved reputation among consumers and financial service industry partners, supporting the continued strong growth of the sector.

11.4 This consultation also examines the scope for introducing additional compensatory measures—as well as some simplification measures—that can mitigate some of the risks and costs associated with the proposals put forward here.

11.5 Initial options for consideration include:

- reducing the burden of forms: close engagement with the sector will be needed to ensure that information requirements by the supervisor:
  - constitute the minimum amount of information necessary to meet HMRC's purposes;
  - prevent the duplication of information provision requests;
  - take account of the different needs and abilities of traders to acquire certain types of information.
- reducing the current burden of inspections: for the lowest risk traders, a more risk-based, intelligence-led approach to visits could allow for a "stepped-down" version of assurance visits;
- further consultation, as part of the development of the new UK Money Laundering Regulations required to implement the 3rd EC Money Laundering Directive in 2007.

11.6 In addition, should the evidence base demonstrate in the future that the risk of money laundering in the MSB sector is no higher than other parts of the regulated sector, the government will move to extend the privilege of "reliance" to MSBs.

11.7 The Third Money Laundering Directive provides reliance mechanisms by which firms can rely on the customer identification arrangements of third parties in the UK financial services industry. These mechanisms could significantly reduce the administration burden involved in performing ID and KYC checks. Though ultimately the responsibility for meeting the customer due diligence requirements of the MLRs remains with the firms themselves, the new reliance mechanism would have a significant positive impact on the administrative burdens of MSBs dealing with other financial service businesses—including other MSBs—whom they know and trust.

11.8 We invite stakeholders to suggest any additional simplification or compensatory measures that could be considered for the sector.

11.9 Besides the option-specific questions raised throughout the document, we welcome views on the following general questions:

- Are there any other issues that we have not raised which are also matters of concern?
- Are you aware of any analysis of the wider economic impacts that we would find useful?
- Is our assessment of the costs and benefits of the options—as outlined in the partial RIA (Annex A) accurate and complete?
- Are there any additional simplification or compensatory measures that could be considered for the sector?

11.10 The consultation period will run until December 6, 2006. We cannot guarantee to consider your response if it arrives after that date. Please send responses to this Consultation Document to:

Money Service Business Team
Room 4/17
HM Treasury
1 Horse Guards Road
London SW1A 2HQ
Fax: (+44) (0) 207 270 5430
Email: fincrime.branch@hm-treasury.gov.uk

11.11 When responding, please state whether you are responding as an individual or representing the views of an organisation. If responding on behalf of a larger organisation, please make it clear who the organisation represents and, where applicable, how the view of members were assembled.

Confidentiality

11.12 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes (these are primarily) the Freedom of Information Act 2000 (FOIA), the Data Protection Act (DPA) and the Environmental Information Regulations 2004). If you want the information that you provide to be treated as confidential, please be aware that, under the FOIS, there is a statutory Code of Practice with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality will be maintained in all circumstances.

11.13 An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on the Department. The Department will process your personal data in accordance with the DPA, and in the majority of circumstances, this will mean that your personal data will not be disclosed to third parties.

11.14 We would welcome contributions throughout the consultation period. In particular, if there are emerging issues or contributions earlier in the process, we can feed these into consultation events for further development. Information on these consultation events and how to get involved in them can be found at: http://www.hm-treasury.gov.uk/Consultations_and_Legislation/consult_index.cfm

11.15 A summary of responses will be published at http://www.hm-treasury.gov.uk/documents/financial_services/fin_index.cfm from 30th September 2006.

11.16 Any Freedom of Information Act queries should be directed to:

Correspondence and Enquiry Unit
Freedom of Information Section
HM Treasury
1 Horse Guards Road
London
SW1A 2HQ
Telephone: +44 (0)20 7270 4558
Fax: +44 (0) 207 270 4681
Email: public.enquiries@hm-treasury.x.gsi.gov.uk

11.17 The Partial Regulatory Impact Assessment (Partial RIA) is published with this document and should be read in conjunction with it. The Partial RIA lays out the options raised for discussion above and considered qualitative, and where possible, quantitative costs and benefits for each option.

11.18 A copy of the Partial RIA can be found on HM Treasury's website: www.hm-treasury.gov.uk or requested through HM Treasury's correspondence and enquiry unit. Contact details can be found on the http://hm-treasury.gov.uk/contact/contact_index.cfm

- The Cabinet Office criteria for consultation are detailed below. A full version of the criteria can be found at http://www.cabinet-office.gov.uk/regulation/Consultation/Code.htm. These criteria apply to all UK public consultations by government departments and agencies, including consultations on EU directives. Respondents are invited to comment on the extent to which the criteria have been adhered to and to suggest ways of further improving the consultation process.
- Consult widely throughout the process, allowing a minimum of 12 weeks for written consultation at least once during the development of the policy.
- Be clear about what your proposals are, who may be affected, what questions are being asked and the timescale for responses.
- Ensure that your consultation is clear, concise and widely accessible.
- Give feedback regarding the responses received and how the consultation process influenced the policy.
- Monitor your department's effectiveness at consultation, including through the use of a designated consultation co-ordinator.
- Ensure your consultation follows better regulation best practice, including carrying out a Regulatory Impact Assessment if appropriate.

11.19 If you feel that this consultation does not fulfil these criteria please contact:

Meenakhi Boorah
HM Treasury, 1 Horse Guards Road
London
SW1A 2HQ
Email: meenakhi.borooah@hm-treasury.x.gsi.gov.uk
Tel: (+44) (0) 207 270 5925

A PARTIAL REGULATORY IMPACT ASSESSMENT

Title of Proposal

A.1 This is the Partial RIA of the consultation proposals put forward by in the consultation document for HM Treasury's review of the enforcement and implementation of the current regulatory regime for Money Service Businesses.

Purpose and Intended Effect

A.2 This section sets out:

- The background to the MSB review;
- The objectives of the MSB review; and
- The rationale for intervention.

The background

A.3 In 2001, the UK Government introduced a new regulatory regime for Money Service Businesses (the sector comprising cheque cashers, bureaux de change and money transfer operators). The regulatory regime exists to ensure that operators have the systems and controls necessary for compliance with the law, and to enable law enforcement to disrupt money laundering and terrorist financing wherever it occurs. These systems and controls include the appointment of a Nominated Officer with responsibility for oversight of all anti-money laundering activity; systems that will identify and report suspicious transactions to the Nominated Officer; the training of staff in control systems and anti-money laundering law; the confirmation of customer identity and the holding of records.

A.4 This enforcement regime itself is explicitly minimalist and is based on a simple registration system which provides HMRC with a point of contact for each trader. Traders pay an annual fee of £60 towards the operation of the regime which consists of assurance visits (monitoring compliance), enforcement visits (tackling money laundering and terrorist financing) and a programme of education and guidance on legal requirements and best practice.

A.5 For further detail on the structure of the current regime, please see Chapter 3 of the accompanying consultation document.

A.6 The objective of government intervention in the MSB sector has always been to strike the right balance between the need to safeguard the sector from the risk of money laundering and terrorist financing (through appropriate controls by industry and effective implementation by government) while avoiding disproportionate burdens which might impact on the competitiveness of this important part of the UK's financial services industry.

A.7 To ensure that performance of the regime continued to meet this objective, the government committed to reviewing the implementation and enforcement of the newly introduced arrangements after a few years of operation.

A.8 Sufficient experience has now been built up to enable a stocktake of the regime's performance. This stocktake has revealed that the regime is not being effectively enforced and consequently is failing to meet government objectives: 45% of the sector has been judged non-compliant; 1/5 of all money laundering investigations

directly involve a MSB; and the low levels of suspicious activity reporting by MSBs is as worrying as the very high levels of suspicious activity reporting to SOCA about MSBs.

A.9 Poor compliance with regime requirements is being exploited for criminal, and in some cases terrorist, purposes—making reform all the more urgent. At the same time, the timing of this consultation is synchronised with the introduction of new EU requirements in relation to anti-money laundering and counterterrorist financing controls, providing the perfect opportunity to inform the sector of new obligations and include MSBs in forthcoming discussions about their implementation.

A.10 The time is therefore right for a review of the supervisory regime for Money Service Businesses.

The objective of the review

A.11 The objective of the review was two-fold: to

- take stock of whether the current enforcement regime adequately manages the risk of money laundering and terrorist financing in the sector;
- outline options to reform the implementation and enforcement of the regime in order to tackle money laundering and terrorist financing effectively and proportionately.

A.12 The consultation document does pose a number of questions for respondents on how best to implement the Third EC Money Laundering Directive's fit and proper test requirement for this sector. The proposal is, however, very much part of the EC Directive's raft of wider proposals and so, to avoid duplication of cost-benefit analysis, will be picked up in its own RIA rather in this document.

Rationale for intervention

A.13 There are clear reasons for having effective, up to date money laundering and terrorist financing controls. These are:

- To provide a disincentive to crime by reducing its profitability. Robust systems of controls to detect, intercept and confiscate criminal funds make it harder for individuals or groups to profit from their crimes;
- To provide a disincentive to crime by reducing the pool of money available to finance future criminal activity. Robust systems of controls to detect, intercept and confiscate criminal funds make it harder for individuals or groups to fund their next crime;
- To aid the detection and prosecution of crime. The intelligence provided from money laundering and terrorist financing controls provides leads that have proved crucial in disrupting terrorism, money laundering and linked offences, in convicting criminals or for identifying assets to assist civil recovery efforts;
- To protect the integrity of the financial system and reputation of UK business. The competitive position of UK business depends upon its reputation for integrity and honest dealing;
- To avoid economic and competitive distortions. Legitimate businesses are disadvantaged when competing against businesses controlled by criminals

who may be willing to accept lower rates of return or even losses to maintain the appearance of being legitimate investments;

- To promote financial inclusion. Financial institutions, particularly banks, may withhold financial services from MSBs if they regard the sector as being particularly vulnerable to financial crime.

A.14 A review of performance to date—to be found in chapters 4 and 5 of the accompanying consultation document—has identified a number of areas in which further steps are required in order to deliver the government's objective of safeguarding the sector from the risk of money laundering and terrorist finance:

- Overall, there are strong grounds to believe that a proportion of MSBs lack the systems and controls necessary to comply with the law, rendering the sector a relatively permissive environment for money laundering and terrorist financing;
- There is significant scope for financial abuse within the MSB sector to be challenged more aggressively and in a more streamlined way – both to hold perpetrators to account and to enhance the compliance culture and reputation of the sector;
- There is scope for the regulator to adopt a more avowedly risk-based approach and for guidance to the sector to be enhanced.

Illustrating the vulnerability of the sector:

- 45% of the sector has been judged to be non-compliant;
- 1/5 of all money laundering investigations directly involve an MSB;
- Suspicious activity reporting by the sector is dropping rapidly—from an already low benchmark—against a trend of increased reporting;
- 1 in every 3 suspicious activity reports received by SOCA are reporting the behaviour of an MSB.

A.15 The rationale for intervention stems from the need to manage the risk of financial abuse in the sector. If unchecked by effective money-laundering controls, the MSB sector provides a means by which criminal profits can be enjoyed and / or recycled into further criminality. Estimates on the annual proceeds from crime in the UK range from £16 billion to £48 billion, with a substantial part of this money—perhaps as much as £25bn—being laundered every year.

A.16 While money laundering trends and techniques vary greatly, the MSB sector provides an attractive facility by which criminal and terrorist funds can enter the financial system. In the context of a general hardening of the environment for criminal and terrorist operators in the UK financial system, if the MSB sector remains a relatively permissive environment—due to lower compliance levels with the MLRs—it will become even more attractive to criminal and terrorist elements.

A.17 Effective controls act as an ongoing deterrent for crime and terrorism, and help limit the wider economic distortions and externalities (such as infrastructural damage, lost tourist income and general business confidence) that arise in a permissive environment for financial crime. Regulatory intervention, then, is an intrinsic part of

government efforts to attack criminal profits. Similarly, money-laundering controls, backed by proper assurance and enforcement, are an elementary building block for government efforts to spot and disrupt terrorist finance.

Consultation

A.18 During the development of the MSB review consultation document and RIA, the review team has engaged strongly with the sector in informal pre-consultation activities. The learning from this engagement was fed into the consultation document and this accompanying RIA to provide the foundation for a close dialogue with the sector during the formal consultation period.

A.19 This Partial RIA lays out the implementation options and considers qualitative, and where possible, quantitative costs and benefits for each option. Risks, unintended consequences and any compliance and enforcement issues have been incorporated as costs and benefits. Competition issues and the impact on small firms have also been considered.

A.20 When formally responding to the Partial RIA we are seeking comments on the analysis of costs and benefits, likely risks and unintended consequences of the proposed options, as well as supporting evidence wherever possible. If you feel there are alternative options, or indeed alternative combinations of existing options, please suggest these. The feedback to this Partial RIA will provide valuable information which will feed into policy following this consultation.

A.21 The consultation document and the Partial RIA should be read together.

Options

A.22 The MSB supervisory regime was designed according to a “start low” principle, in an effort to ensure that only the minimum necessary level of implementation and enforcement would be required of the sector and supervisory authority. Alongside the establishment of the regime was the commitment to review the regime to ensure that the “minimum necessary” level of enforcement and supervision, set for the first phase of the regime’s evolution, continues to be sufficient to protect honest and legitimate businesses whilst effectively targeting those who abuse the system.

A.23 As mentioned above, a review of performance to date has identified a number of areas in which further steps are required in order to deliver the government’s objective of safeguarding the sector from the risk of money laundering and terrorist finance. Chapters six, seven and eight of the document outline these steps as a selection of complementary measures that in aggregate would strongly challenge money laundering and terrorist financing in the MSB sector in a more effective and risk-based way.

A.24 The proposals are to:

- improve the speed and efficiency of criminal and terrorist financial investigations, as well as enabling timely arrests, prompt asset freezing, and successful prosecutions through:
    - a notably more risk-based and intelligence-led targeting of assurance and enforcement visits, with additional data collection by operators enabling risk assessment and so heightened surveillance on highest-risk operators;
    - the specification in guidance of HMRC’s requirement for financial records to be provided on request in a consistent form, and in English to establish actionable audit trails for investigators;

- strengthen the sector's compliance culture and improving compliance with money laundering and terrorist finance regulations through :
  - enhanced guidance for, and engagement with, the sector;
  - a reinforced assurance and enforcement function with HMRC robustly tackling persistent non-compliance among MSBs, including through prosecution.

A.25 Taken together, the proposals outlined above are also designed to:

- ensure the law is enforced and the regime effective;
- improve the competition in the sector by levelling the playing field for the legitimate majority;
- improve the reputation of the sector, among consumers and financial service industry partners, supporting the continued strong growth of the sector; and
- provide additional protection for consumers.

A.26 It is important to note, however, that although the proposals are outlined below as distinct "options", they are not all substitutable and instead should be seen as complementary and mutually reinforcing options that in some combination will form part of a proportionate and robust enforcement response.

ASSURANCE AND ENFORCEMENT POLICY

A.27 Chapter eight of the consultation document discusses proposed changes to assurance and enforcement policy that will bolster the regime's effectiveness in detecting, disrupting and deterring abuse of the system and persistent non-compliance.

A.28 These proposed changes relate to:

- a more proactive compliance function with HMRC to seek out and address non-compliance in the sector, including through the devolution of more specialist tasks to front-line assurance officers; and
- a more proactive sanctions regime in which persistent non-compliance is swiftly penalised with appropriate sanctions (already on the statute book) in order to create a strong deterrent effect.

Option 1 Do Nothing

Benefits

A.29 The only apparent benefit of making no change to assurance and enforcement policy is that there would be no additional financial cost to running the assurance and enforcement regime and so no associated uplift in annual fees for the sector.

Costs

A.30 If the MSB sector remains a relatively permissive environment in the context of a general hardening of the environment for criminals and terrorists across the rest of the UK financial system, the MSB will be perceived as an increasingly attractive sector through which to launder money and finance terrorism. The costs of this scenario to the sector include:

- an increasingly ununeven playing field for legitimate and compliant traders;
- severe reputational damage to a sector currently facing significant reputational challenges; as well as
- higher costs to society, and so indirectly to the sector, that have already been outlined in the sections detailing the objectives of the review and the rationale for intervention.

Option 2 Make changes to assurance and enforcement policy

A.31 This option reflects those changes discussed in paragraphs 8.2 and 8.14 of the accompanying consultation document—plus the costs of likely changes to policing the perimeter policy (touched on in para 6.13), which have been included as part of the assurance and enforcement package for completeness.

Benefits

A.32 The direct benefits of these changes include:

- Improved detection (and speed of detection) of non-compliance;
- Swifter and more proportionate sanctions applied to persistent non-compliance;
- Focus for education visits where non-compliance detected is not wilful but through ignorance.

A.33 The indirect benefits include:

- Reduction in non-compliance (among both the wilfully non-compliant and those non-compliant through ignorance);
- Levelling of the playing field as competitive advantage of non-compliance is removed through credible threat of detection and penalties;
- Hardening of the environment for financial criminals and terrorist financiers;
- Increased disruption of financial criminal and terrorist activities.

A.34 The benefits of this measure therefore fall principally to the sector, to HMRC and to society at large.

Costs

A.35 These measures chiefly relate to changes of business practice within HMRC, which administers the assurance and enforcement regime. Where additional resources are necessary to resource the regime, then these additional cost will fall to the sector. Preliminary estimates are that between £50 and £100 would be required from each premises while the more intensive enforcement programme is in operation.

A.36 The highest risk traders, and the non-compliant traders, will also bear the additional inspection burden associated with the changes, with the latter also bearing the costs of any penalties levied.

Risks

A.37 The biggest risk lies with the additional financial and administrative cost of the option. Additional costs to consumers, as mentioned above, impact upon the financial inclusion and development agendas and additional costs to businesses can mean bankruptcy for those at the margins of commercial viability. As before, the extent to which these risks are borne out depends very much on the extent to which the benefits outweigh the costs. We should not underestimate the benefits that a levelling of the playing field will deliver to legitimate, compliant traders.

ENABLING RISK-ASSESSMENT

A.38 Many of the potential changes to the assurance and enforcement of the regime would benefit from the adoption of a more avowedly risk-based approach to supervision. Chapter 8 of the consultation asked what sort of information would enable effective risk-assessment. Initial suggestions are that useful information might include annual turnover, most frequent value of transactions, main customer type, most frequent type of transaction, estimate of future trading, top three destination countries, three main currencies transmitted, or source of funds. The consultation will hopefully clarify our understanding of the levels of difficulty facing MSBs in providing these different pieces of information, so that we may ensure that our requirements can achieve our risk-assessment objectives without posing a disproportionate burden.

A.39 In order to undertake such risk-assessment, however, a mechanism for collecting the information required would need to be established. Options 4, 5, 6 and 7 represent options suggested by the consultation document as suitable mechanisms. These include requiring a summary of business transactions akin to those that traders are required to produce for VAT purposes (option 4), the submission of a minimalist or more comprehensive questionnaire by traders (options 5 and 6), or the manual collection of data by assurances officers (option 7).

Do Nothing

Benefits

Option 3

A.40 The only apparent benefits of not basing the targeting of assurance and enforcement activities on risk-assessment is that there would be no financial costs borne by the sector to set up and maintain such a programme, and there would be no ongoing administrative costs to the sector associated with collecting and storing relevant information.

Costs

A.41 Risk assessment would enable assurance and enforcement activity to be tightly focused on the highest-risk traders. A decision against the use of such risk-assessment would incur the following costs:

- Assurance and enforcement resources would continue be allocated suboptimally as their focus would be spread more evenly across the sector rather than being applied to the areas of highest risk;
- Lowest risk traders would continue to bear a burden of inspection disproportionate to the risks facing them.
- Additionally, risk-assessment is critical to achieving many of the objectives for option 2 and so choosing the "do nothing" approach to risk-assessment

would contribute to many of the costs associated with option 1, including the higher level costs to society and the sector as outlined in the sections detailing the objectives of the review and the rationale for intervention.

Option 4 Use Summary of Business Transactions

(reflecting changes discussed in para 8.7 of the consultation document)

Option 5 Use Minimalist Questionnaire

(reflecting changes discussed in para 10.6 – 10.10 of the consultation document)

Option 6 Use Comprehensive Questionnaire

(reflecting changes discussed in para 10.6 – 10.10 of the consultation document)

Option 7 Assurance officer collection

(also reflecting changes discussed in para 10.6 – 10.10 of the consultation document)

A.42 As mentioned above, the costs and benefits of options 4-7 are largely the same in terms of their qualitative description and where they impact; they differ only in quantity and extent. For this reason, to avoid unnecessary duplication, the costs and benefits of options 4-7 will be discussed below in aggregate—with option specific costs and benefits outlined where they can be distinguished.

A.43 As this is essentially a prerequisite for much of the activity outlined in option 2, it follows that this option contributes to many of the high-level benefits, costs and risks outlined for that option. The lower-level, and more direct, benefits, costs and risks are outlined below.

Benefits

A.44 The direct benefits of the risk-assessment that options 4-7 would produce include:

- Improved detection (and speed of detection) of non-compliance;
- More cost-effective regime as resources are being applied to areas of highest risk;
- Focus for education visits where non-compliance detected is not wilful but through ignorance;
- A lightening of the inspection burden and administrative load on low risk MSBs relative to high risk businesses;
- Improved understanding of the sector and trends within it. This will increase our knowledge of trends in global cash and money transfers and will be valuable in the fight against money laundering and terrorist financing at the international level.

A.45 The indirect benefits include their contribution to the following:

- Reduction in non-compliance (among both the wilfully non-compliant and those non-compliant through ignorance);
- Levelling of the playing field as competitive advantage of non-compliance is removed through credible threat of detection and penalty;
- Hardening of the environment for financial criminals and terrorist financiers;
- Increased disruption of financial criminal and terrorist activities.

A.46 The benefits of options 4-7 therefore fall principally to the sector, to HMRC, to society at large and to our international partners working to tackle terrorist financing and money laundering.

The level of benefit to be derived varies, however, in direct proportion to the amount of necessary information provided by the sector. In order to discriminate between levels of risk, supervisors will need enhanced information of certain risk indicators – such as size of annual turnover; levels of business conducted in cash; common remittance destinations. As the judgement on the information requirement is yet to be made, it is entirely possible that options 4, 5 and 7 would not draw sufficient information or that option 6 would provide more information than the minimum necessary for the purposes of robust risk assessment. A judgement on the relative benefits of each option cannot at this stage be made.

Costs

A.47 The largest associated cost with all four options involving risk-assessment will be the establishment of the IT capacity required to log information and perform the risk assessment itself. Initial estimates for the cost of developing such capacity are around £8 million pounds. Adding to this the ongoing financial cost to traders of financing ongoing risk-assessment once the capacity is established (estimated at between £9,600 and £75,000 across the sector), plus the administrative cost for the sector of recording the information for submission or for assurance officers to collect (estimated to cost up to £0.32 per transaction), the costs of these options range from around £8,000,000 up to £9,000,000. For more information, the table at the end of the options section very clearly and conveniently sets out these costs.

A.48 Administrative decisions on how these costs will be met will be made by HMRC, but as the majority of these start up costs will be translated into fees. Initial expectations are for the costs to be recovered gradually over time and at levels decided by sliding scale according to MSB size—in order to ensure that the costs are not felt disproportionately by the smaller firms in the sector.

A.49 Importantly, the inspections burden on traders, as a whole, would not increase. A risk-based, intelligence-led approach to visit targeting will enable additional attention to be paid to the highest-risk traders and less attention paid to those identified as particularly low-risk—with no net expansion to the inspections programme.

Risks

A.50 The biggest risk lies with the additional financial and administrative cost of the option, for example, by bankrupting firms at the very margins of commercial viability.

A.51 It must be noted at this point, however, that the context for this proposal—and its accompanying costs and risks—is the need for risk-based, intelligence-led focusing of assurance and enforcement efforts. The benefits of this proposal will fall much further downstream as it is expected to have a generous impact on the effectiveness of the regime.

A.52 In terms of risk mitigation, there are a couple of measures specific to this proposal that are up for consideration. First, risk-based, intelligence-led visit targeting will mean that the inspections burden will be focused on highest-risk traders. Correlated to this is the ability to scale down the assurance visits to the lowest-risk traders—lightening the burden of inspections and administration for them. Moreover, the administrative burden could be to some degree reduced by maximising trader involvement in the drawing up of the documents/forms in which the data will be recorded—as the requirement would be tailored to the needs and abilities of the sector.

RECORDKEEPING REQUIREMENTS

A.53 Option 9, discussed in chapter 8 of the consultation document, relates to the effectiveness of the current regime, particularly in terms of investigations and prosecution. Insufficient and incomplete records, and records provided in languages other than English, have been seriously hampering investigations and are therefore undermining attempts to present a credible threat of detection, disruption and sanctions. The proposal is that guidance be amended to specify HMRC's requirement for financial records to be provided on request in a consistent form, and in English to establish actionable audit trails for investigators.

Option 8 Do Nothing

Benefits

There is no apparent benefit in refraining from clarifying these requirements.

Costs

The costs of doing nothing include:

- Records being returned to traders for translation into English before resubmission creating extra and unnecessary work for traders, particularly those who would have chosen to keep records in English to avoid the cost and inconvenience of translation of records on request;
- Potential unnecessary action against traders who through ignorance are failing to meet their legal obligation to maintain complete and consistent records;
- ongoing costs in terms of delays to investigations.

Option 9 Clarification of recordkeeping requirements

A.54 This option reflects the changes discussed in paragraph 8.11 in the accompanying consultation document.

Benefits

The benefits of these options would be:

- A speeding up of the investigative and prosecutorial process, as well as a bolstering of its effectiveness as the quality of evidence would be improved;
- Provision of an audit trail and a starting point for investigators—which would also improving the speed and efficiency of investigatory work—and which would be expected to lead to improved detection and disruption of criminal activity;
- The generation of a deterrence culture, as the credible threat of detection, disruption, and sanctions will become stronger and more visible.

A.55 Given that this option will essentially improve the effectiveness, and cost-effectiveness, of the current regime, the main beneficiaries will be the taxpayer, HMRC, and the law-abiding traders in the MSB sector.

Costs

A.56 This option is not a change to regulatory requirements nor to supervisory powers—it is instead the explicit decision to make use of such powers more consistently. Traders are already obliged under the MLRs to keep complete, consistent records and to furnish HMRC with information in any format the supervisor requires. HMRC will enforce these obligations and apply penalties where appropriate—but only those traders choosing to be non-compliant will incur additional costs.

A.57 Finally, for the regulator, putting the option in place has only negligible associated costs—the guidance for the sector is due to be updated anyway therefore this clarification could be made with very little marginal cost.

Risks

A.58 As only those traders currently non-compliant will incur additional costs, additional administrative burdens will fall largely to those non-compliant traders. The additional cost to the non-compliant part of the sector could mean that those non-compliance traders at the margins of commercial viability—most likely surviving due to the competitive advantage of their non-compliance—could face bankruptcy.

GUIDANCE

A.59 Chapter seven discusses the final proposal of the review—the provision of better guidance to the sector. The aim is to ensure future guidance:

- Reflects industry views gathered via consultation with MSBs, both with trade associations and individual businesses;
- Provides clarity on obligations where awareness among the sector is poorest;
- Is updated to reflect changes in legislation promptly, and new obligations are made clear;
- Is flexible and able to accommodate changes in technology and business practices;
- Is consistent as far as possible with JMLSG guidance and with other parts of the regulated sector;
- Is Treasury approved for PoCA and MLR purposes; and
- Is easily accessible to the MSB sector.

Option 10 Do Nothing

Benefits

A.60 Only apparent benefit is the removal of the cost burden that would have been incurred by HMRC in the production of new guidance, and by the sector where it voluntarily engaged in consultation with HMRC on the guidance content.

Costs

A.61 The main cost of doing nothing would be the opportunity cost involved—the missed opportunity to improve awareness of obligations, to make the guidance more practical and more forward-looking. As the Hampton Review argues, good guidance and advice can help reduce administrative burdens and increase probability of compliance. Doing nothing would not capitalise on the scope for improving the current guidance and so would miss the opportunity to achieve the expected benefits.

Option 11 Better guidance

A.62 This option reflects those changes discussed in Section 9 in the accompanying consultation document.

Benefits

A.63 The benefits of this option include:

- Improved awareness of obligations, thus improving compliance and consequently reducing the enforcement burden (and so the annual fee cost for industry);
- Improved compliance as guidance on how to meet regulations is written with a deeper understanding of the nature and needs of the sector;
- Reduced risk that time and money will be wasted through efforts of compliance that (a) fail to meet requirements; or (b) go beyond requirements;
- Increased consistency with the JMLSG guidance will improve understanding for rest of financial services sector around nature of AML/CTF requirements on the MSB sector, leading to more informed business relationships overall as well as a corresponding improvement in the reputation of the sector;
- More regularly updated guidance reflecting new and forthcoming changes will reduce the risk of businesses of becoming non-compliant through ignorance, saving the businesses costs associated with administrative penalties, as well as reputational damage.

A.64 The benefits fall to the sector, to HMRC, and to society at large.

Costs

A.65 The costs of this measure are small and split between the sector and HMRC. For the sector, these include:

- The cost of spending time in consultation with HMRC in order to design tailor-made guidance for the sector. This will be as little or as much as each business wants—and much of the burden will be picked up by trade associations, as well as HMRC;
- The cost of familiarising businesses with the guidance itself;
- The indirect cost of production and publication of the guidance passed on through the annual fee—estimated to be around £1 per trader.

Risks

A.66 The risks associated with this proposal are negligible.

A.67 The accompanying tables are provided a clear and convenient summary of the costs and benefits expected from the options outlined above. Readers are requested to be aware that these figures are only preliminary estimates intended to be indicative only. We are particularly keen to elicit views on the accuracy of these estimates—with evidentiary support where possible—as well as the wider operational impact these options may have on traders.

Compensatory and Simplification Measures

A.68 The objective of the review is to facilitate the evolution of the regulatory regime for MSBs in order to maintain an efficient, dynamic MSB sector that is properly protected from the risk of financial abuse for money laundering and terrorist financing purposes. In addition to the achievement of key AML and CTF objectives, for the sector this will mean:

- improved competition in the sector due to the levelling of the playing field for the legitimate majority;
- improved reputation of the sector, among consumers and financial service industry partners, supporting the continued strong growth of the sector.

A.69 The consultation process will also, however, examine the scope for introducing additional compensatory measures—as well as some simplification measures—that can mitigate some of the risks and costs associated with the proposals put forward.

	Start-up costs (financial)	Ongoing costs (financial)	Ongoing costs (admin)	Total each option
Option 2 (para 8.3 in the consultation document)	None	£160-320 k across the sector	No overall additional admin burden across the sector	£160-320 k across the sector
Option 4 (para 8.7)	£8 million	£10,000	From £0 to £0.32 per transaction	£8,010,000 plus from £0 to £0.32 per transaction
Option 5 (para 8.6)	£8 million	£10,000	£3000 plus from £0 to £0.32 per transaction	£8,013,000 plus from £0 to £0.32 per transaction
Option 6 (para 8.6)	£8 million	£40,000	From £75,000 plus from £0 to £0.32 per transaction	£8,115,000 plus from £0 to £0.32 per transaction
Option 7 (para 8.6)	£8 million	£13,000	£16000 plus from £0 to £0.32 per transaction	£8,029,000 plus from £0 to £0.32 per transaction
Option 9 (para 8.12)	**No additional burdens for compliant traders associated with clarification of existing requirements**			
Option 11 (para 7—7.6)	None	£3000	£95000	£98,000
		Total cost of preferred options		
Options 2, 5, 9, 11	**Less than £9,000,000 across the sector plus between £0 and £0.32 per transaction**			

Costs of "doing nothing"	
High level costs of "doing nothing"	• As a sector dealing with large amounts of cash, unchecked by effective money laundering controls the MSB sector will continue to provide an attractive means by which criminal profits can be enjoyed and/or recycled into further criminality. Estimates on the annual proceeds of crime in the UK range from £16 billion upwards, with a substantial part of this money being laundered every year; • In the context of a general hardening of the environment for terrorist operators in the UK financial system, if the MSB sector remains a relatively permissive environment—due to lower compliance levels with the MLRs—it will become even more attractive to terrorist elements; • Money laundering and terrorist financing bring with them wider economic distortions and externalities (such as infrastructural damage, lost tourist income and general business confidence) that would have a significantly negative impact on society—and on traders in this sector; • This scenario would bear high costs in terms of damage to the sector's reputation. The accompanying review has found enforcement of the regime to be seriously lacking, and compliance with the regime particularly low. Given recent claims that business relationships, particularly with banks, are already suffering due to the poor reputation of the sector in terms of compliance with AML/CTF requirements, any report shedding further doubt on the compliance of the sector –without proposing action to address the situation—will have a significant negative impact on the sector; • The suffering of legitimate traders due to the increasingly uneven playing field will continue if the competitive advantage available through non-compliance goes unchecked.
Option 1	• Again, an increasingly uneven playing field for legitimate and compliant traders; • Again, severe reputational damage to a sector currently facing significant reputational challenges.
Option 3	• Assurance and enforcement resources would continue be allocated suboptimally as their focus would be spread more evenly across the sector rather than being applied to the areas of highest risk; • Lowest risk traders would continue to bear a burden of inspection disproportionate to the risks facing them.
Option 8	• Future traders being required to resubmit records after translation into English—creating extra and unnecessary work for traders, particularly those who would have chosen to keep records in English to avoid the cost and inconvenience of translation of records on request; • Potential unnecessary action against traders who through ignorance are failing to meet their legal obligation to maintain complete and consistent records; • Ongoing costs in terms of delays to investigations.
Option 10	• The main cost of doing nothing would be the opportunity cost involved—the missed opportunity to improve awareness of obligations, to make the guidance more practical and more forward-looking. The Hampton Review argues that good guidance and advice can help reduce administrative burdens and increase probability of compliance.

Options	Benefits
	If unchecked by effective money-laundering controls, the MSB sector provides a means by which criminal profits can be enjoyed and / or recycled into further criminality. Estimates on the annual proceeds from crime in the UK range from £16 billion to £48 billion, with a substantial part of this money—perhaps as much as £25bn—being laundered every year. While money laundering trends and techniques vary greatly, the MSB sector provides an attractive facility by which criminal and terrorist funds can enter the financial system. In the context of a general hardening of the environment for criminal and terrorist operators in the UK financial system, if the MSB sector remains a relatively permissive environment—due to lower compliance levels with the MLRs—it will become even more attractive to criminal and terrorist elements.
High level benefits of the set of preferred options	• The provision of a disincentive to crime by reducing its profitability. Robust systems of controls to detect, intercept and confiscate criminal funds make it harder for individuals or groups to profit from their crimes. • The provision of a disincentive to crime by reducing the pool of money available to finance future criminal activity. Robust systems of controls to detect, intercept and confiscate criminal funds make it harder for individuals or groups to fund their next crime. • The aiding of the detection and prosecution of crime. The intelligence provided from money laundering and terrorist financing controls may provide leads, which can be crucial in disrupting terrorism, money laundering and linked offences, in convicting criminals or for identifying assets to assist civil recovery efforts. • The protection of the integrity of the financial system and reputation of UK business. The competitive position of UK business depends upon its reputation for integrity and honest dealing. • The avoidance of economic and competitive distortions. Legitimate businesses are disadvantaged when competing against businesses controlled by criminals who may be willing to accept lower rates of return or even losses to maintain the appearance of being legitimate investments. • The promotion of financial inclusion. Financial institutions, particularly banks, may withhold financial services from MSBs if they regard the sector as being particularly vulnerable to financial crime.
Option 2 specific benefits	• Improved detection (and speed of detection) of non-compliance • Swifter and more proportionate sanctions applied to persistent non-compliance • Reduction in inspection and administrative burden for those identified as lowest risk • Reduction in non-compliance (among both the wilfully non-compliant and those non-compliant through ignorance) • Levelling of the playing field as competitive advantage of non-compliance is removed through credible threat of detection and penalties • Increased disruption of financial criminal and terrorist activities.
Option 4,5,6,7 specific benefits	• Improved detection (and speed of detection) of non-compliance; • More cost-effective regime as resources are being applied to areas of highest risk; • Focus for education visits where non-compliance detected is not wilful but through ignorance; • A lightening of the inspection burden and administrative load on low risk MSBs relative to high risk ones; • Improved understanding of the sector and trends within it. This will increase our knowledge of trends in global cash and money transfers and will be valuable in the fight against money laundering and terrorist financing at the international level.
Option 9 specific benefits	• A speeding up of the investigative and prosecutorial process, as well as a bolstering of its effectiveness as the quality of evidence would be improved • Provision of an audit trail and a starting point for investigators—which would also improving the speed and efficiency of investigatory work—and which would be expected to lead to improved detection and disruption of criminal activity • The generation of a deterrence culture, as the credible threat of detection, disruption, and sanctions will become stronger and more visible.
Option 11 specific benefits	• Improved awareness of obligations, thus improving compliance and consequently reducing the enforcement burden; • Improved compliance as guidance on how to meet regulations is written with a deeper understanding of the nature and needs of the sector; • Reduced risk that time and money will be wasted through efforts of compliance that (a) fail to meet requirements; or (b) go beyond requirements; • Increased consistency with the JMLSG guidance will improve understanding for rest of financial services sector around nature of AML/CTF requirements on the MSB sector, leading to more informed business relationships overall as well as a corresponding improvement in the reputation of the sector; • Accommodation of changes in technology and business practices will enable the ongoing communication of new, less burdensome, means by which MSBs may meet the regulatory requirements. This will give the sector to use such burden-reducing measures, directly reducing the administrative burden; • More regularly updated guidance reflecting new and forthcoming changes will reduce the risk of businesses of becoming non-compliant through ignorance, saving the businesses costs associated with administrative penalties, as well as reputational damage.

A.70 In addition to the benefits of the options outlined in the table above, there are a number of additional options being considered to further offset the costs of the options above.

A.71 Initial options for consideration include:

- Reducing the burden of forms: It should be understood that these efforts to reduce the burden of forms would be in the context of an increased overall burden—and as such are not absolute reductions, but offsetting measures. These efforts would include:
  - Requiring the minimum amount of information necessary to meet HMRC's purposes;
  - Prevention of the duplication of information provision requests;
  - Taking account of the different needs and abilities of traders to acquire certain types of information.
- Reducing the current burden of inspections for the lowest risk traders, putting the information collected to use in the operation of a more risk-based, intelligence-led visit targeting programme—which allows for a "stepped-down" version of assurance visits for those identified as lowest risk. For example, those flagged as lowest risk could have their assurance visits carried out during their VAT inspection rather than in a separate visit. Estimated savings from this option are £400000;
- Consultation in the drafting of the new UK Money Laundering Regulations that will be required as a result of the 3rd EC Money Laundering Directive. Consultation will be required to ensure that the details of implementation of the Regulations take account of the nature and needs of the MSB sector—minimising burdens upon traders whilst protecting MSBs from terrorist and financial criminal abuse and delivering reputational and competition benefits.

A.72 In addition, when the evidence base shows that money laundering through MSBs is reduced to the same kind of level as other sectors, the government will extend the privilege of "reliance" to MSBs. The Third Money Laundering Directive provides reliance mechanisms by which firms can rely on the identification arrangements of third parties in the UK financial services industry. These mechanisms could significantly reduce the administration burden involved in performing ID and KYC checks. Initial estimates for cost savings that might be delivered through reliance are in the region of £1,300,000 annually across the sector. Though ultimately the responsibility for meeting the customer due diligence requirements of the MLRs remains with the firms themselves, the new reliance mechanism would have a significant positive impact on the administrative burdens of MSBs dealing with other financial service businesses—including other MSBs—whom they know and trust.

A.73 These estimates mean that the package of options put forward as a whole is deregulatory as the ongoing annual cost of the regime is estimated to cost less than £1 million a year whereas the benefits and offsetting measures are expected to eventually deliver substantially more than that in cost savings to industry.

Small Firms Impact Test

A.74 It is clear that these options will have an impact on small businesses in the MSB sector, because aside from a handful of large companies, almost all MSBs can be defined as small firms.

A.75 Concerned about this impact, the Review Team has engaged in discussions with the Small Business Service in DTI, and with HMRC—responsible for supervising MSBs—to gain a deeper understanding of the implications of these options on the sector. We have held meetings with representative bodies to get preliminary feedback on the options. The review team held a series of pre-consultation events to engage more deeply and directly with the small firms in this sector, as part of a small firms impact test. The details of the firms consulted at this pre-consultation stage can be found in Annex E.

A.76 The review concludes from these discussion with industry that the benefits of these measures to small firms clearly outweigh their costs. However, we would welcome comments from stakeholders as to whether this is the case.

Competition Assessment

A.77 The UK MSB market is fairly concentrated, with the biggest firm controlling 51% of premises, and the top three firms controlling 66% of all premises. The rest of the market is largely made up of small firms—often sole premises. It follows from this that where regulatory burdens come with additional costs for firms in the sector, the large firms will be better positioned to absorb these costs than their smaller competitors.

A.78 We believe, however, that the impact of these additional costs on the competitiveness of this sector will be minimal for the following reasons:

- Many of the increase costs will be reflected in an increased fee charged per set of premises. This will mean that the top three firms, controlling 66% of the premises, will pay roughly 2/3 of the fees collected for the resourcing of the regime—the fees being paid reflecting the share of the market (and enforcement costs) that the firm represents;
- The small firms impact test revealed that small firms are largely welcoming of the proposals—no firms expressed the concern that the proposals might put them out of business—indicating that the proposals are unlikely to affect the market structure;
- The proposals themselves are designed to level the playing field for firms, working to improve competition in the sector.

A.79 Finally, we are not aware of any specific areas where these proposals would:

- Penalise new entrants—as there are no set-up or ongoing costs that existing firms will not have to meet;
- Limit technological change;
- Prevent firms providing products or services that they would otherwise provide.

A.80 We would, of course, welcome information from stakeholders if they are aware of any such areas.

A.81 We therefore conclude that the proposals put forward are not likely to have any significant negative impact on competition on this sector; instead, the positive benefits that they are expect to deliver will result in a net positive impact on competition.

A.82 We would welcome comments from respondents as to whether they agree with our competition assessment or whether they believe there are significant impacts that we have missed.

Enforcement, Sanctions and Monitoring

A.83 This review was established to assess the effectiveness of the implementation and enforcement of the regulatory regime for MSBs that was established by the 2001 UK Money Laundering Regulations. The regulations themselves are the concern of the Third EC Money Laundering Directive and the forthcoming 2007 MLRs and so are largely outwith the scope of this review.

A.84 The only exception to this is the discussion around the implementation of the 3rd Money Laundering Directive's "fit and proper test" requirement: it was considered that the MSB Review was the appropriate context for a discussion with this particular sector about the implementation of a fit and proper test for MSBs. All other proposals in the review are non-regulatory in nature and focused deliberately on the effectiveness of the implementation and enforcement of the MSB regime. Details of these proposals can be found in chapters 5, 6 and 7 of the consultation document.

B RELEVANT FORTHCOMING LEGISLATION

THE THIRD MONEY LAUNDERING DIRECTIVE

B.1 The Third EC Money Laundering Directive amends and consolidates the previous two money laundering Directives. The main aim of the Third Directive is to take account of the revised 40 Recommendations of the Financial Action Task Force (FATF), which sets the global standard on anti-money laundering measures. Through this, MLD3 continues to strengthen the pan-European framework for the fight against money laundering and terrorist financing; and ensures that new risks/vulnerabilities are targeted. By signing up to the Directive, its shows the UK's commitment to the EU fight against criminality and terrorism.

B.2 The Directive will further enhance the integrity of the regulated sector and take away the disadvantage businesses have when competing against companies that are used and controlled by criminals who may be willing to accept lower rates of return or even losses to maintain the appearance of being legitimate investments. Furthermore, it will also improve the competitiveness between the UK regulated sector and the regulated sector in other countries as the Directive will also bring all EU countries up to the global standard for anti money laundering/counter terrorist financing controls, which the UK already largely meets.

B.3 The main impact of the Directive on the sector is the more detailed requirements for MSBs to know their customer, including performing enhanced due diligence on high-risk non face to face transactions and when establishing a business relationship with politically exposed persons. The Directive also includes a requirement for all owners of money service businesses to be subject to a fit and proper test.

B.4 The Directive also incorporates a key element of the UK's anti-money laundering strategy which is to apply a flexible, risk-based and intelligence-led approach to customer due diligence (know your customer). This approach allows the regulated sectors to adjust their level of due diligence in response to the money laundering/terrorist-financing vulnerabilities and threats associated with each sector and client.

The following provisions remain unchanged from the current 2003 Money Laundering Regulations:

- The reporting requirements;
- The requirement for training and appointing Money Laundering Reporting Officers;
- The predicate offences underlying money laundering.

B.5 The Directive was formally adopted by the European Council on 20th September 2005, and it came into force on 15th December 2005. The UK has two years to fully implement the Directive, that is updating domestic legislation and ensuring that the regulated sector is compliant with it by 15th December 2007.

PAYMENTS REGULATION

B.6 The Payments Regulation implements the seventh Special Recommendation of the Financial Action Task Force (FATF) within the European Union.

B.7 The Special Recommendation is a key part of international efforts to combat money laundering and terrorist financing. Specifically, it aims to ensure that basic information on the originator of wire transfers is immediately available (1) to appropriate law enforcement and/or prosecutorial authorities to assist them in detecting, investigating, prosecuting terrorists or other criminals and tracing the assets of terrorists or other criminals, (2) to financial intelligence units for analysing suspicious or unusual activity and disseminating it as necessary, and (3) to beneficiary financial institutions to facilitate the identification and reporting of suspicious transactions.

B.8 More details on the Special Recommendation are available at: www.fatf-gafi.org/document/53/0,2340,en_32250379_32236947_34261877_1_1_1_1,00.html#insrVII

B.9 In implementing the Special Recommendation in the EU, the Regulation will:

- sets out the extent of information on originators of wire transfers that payment service providers must obtain and verify;
- require that this information is retained by the payer's payment service provider for transfers going within the EU;
- require that this information is sent with the wire transfer by the payer's payment service provider for transfers going outside the EU
- set out the responsibilities of recipient payment service providers in the EU to detect any failure to send information.

B.10 The European Commission adopted a proposal for the Regulation in July 2005. This proposals is available on the Commission's website at: http://europa.eu.int/comm/internal_market/payments/transfers/index_en.htm

B.11 It is expected that the Regulation will receive final adoption this Autumn and come in to force on December 31 2006, with penalties for non-compliance coming into effect on 1 January 2007.

PAYMENTS DIRECTIVE

B.12 In December 2005 the European Commission published a proposal for a Directive on payment services in the internal market. This Directive aims to address concerns about the current state of payment systems in the EU.

B.13 The proposal is available on the Commission's website at: http://europa.eu.int/comm/internal_market/payments/framework/index_en.htm

B.14 The European Commission believe fragmented national systems and the lack of an internal market in payment services are having a negative impact on the EU's competitiveness.

B.15 This Directive aims to tackle these concerns in two ways. First, it harmonises the legal and technical requirements relating to the provision of payments services and introduces a new EU-wide licensing regime for "Payment Institutions". These are businesses which offer payment services but which are not licensed as banks or e-money issuers. They will be subject to a lower level of regulation reflecting the risks involved in the provision of payment services, which are lower than those of deposit-taking institutions, like banks.

B.16 Secondly, it provides the legislative underpinning for the creation of a Single Euro Payments Area (SEPA). The creation of SEPA is intended to enable cross-border payments in Euro to be made as cheaply, easily and efficiently as payments within individual Member States.

B.17 Negotiations on this Directive are still ongoing and are expected to last until late 2006.

B.18 HM Treasury published a consultation document on this proposed Directive on 3rd July 2006. We invite comments from all interested stakeholders by 25th September.

B.19 The consultation document is available on HM Treasury's website at: http://www.hm-treasury.gov.uk/consultations_and_legislation/payment_services_directive/consult_payment_services_index.cfm

E-MONEY DIRECTIVE REVIEW

B.20 A review of the EC E-Money Directive is expected to be published in Summer 2006. We await the report and policy recommendations in order to judge what the implications of the review are for the regulation of e-money issuers in the UK.

B.21 It is helpful, however, to use this opportunity to highlight what the Government currently considers a "regulatory gap" between Money Service Businesses and eMoney issuers. The issue of electronic money is a Regulated Activity under the Financial Services and Markets Act 2000. The FSA is competent authority under the act and so eMoney issuers are required to seek authorisation from the FSA in order to trade.

B.22 Small eMoney issuers can seek a waiver which exempts them from regulation by the FSA. Once waivered, these issuers must register with HMRC for supervision. This supervision is carried out under the auspices of the MSB regime. We feel that the AML requirements put upon small eMoney issuers should be tailored to the nature of their business—as is the case for eMoney issuers regulated by the FSA. Given this, consideration will need to be given to how best to fill this regulatory gap.

C RELEVANT CURRENT LEGISLATION

C.1 The Cabinet Office Performance and Innovation Unit, in its June 2000 report "Recovering the Proceeds of Crime" recommended a light touch regime for regulating firms that engage in "Money Service Business". All institutions that engage in MSB activities have been subject to the Money Laundering Regulations 1993 (SI 1993 No 1933) since 1994. They require all institutions to implement a system of anti-money laundering controls, including: appointing a MLRO, identifying customers where a single transaction exceeds €15000 or where there is an ongoing business relationship; keeping records; and having systems in place to facilitate the reporting of suspicious transactions (SARs). Unlike most financial businesses, however, firms that conducted MSB activities were not subject to formal supervisory oversight.

C.2 In November 2001, the Treasury made the Money Laundering Regulations 2001 (SI2001 No 3641), establishing a supervisory regime operated by Customs and Excise (HMCE). All MSB operators are now obliged to register with HMRC, which has the power to enter and inspect MSB premises to ensure compliance with the current 2003 MLRs.

UK 2003 MONEY LAUNDERING REGULATIONS

What Anti Money Laundering Policies and Procedures are required?

C.3 The guidance to the industry on following the MLRs outlines the key requirements that MSBs should:

- Control their business by having anti money laundering systems in place;
- Appoint a Money Laundering Reporting Officer (MLRO);
- Train staff;
- Apply 'Know Your Customer' (KYC) measures;
- Hold all records for at least five years after the end of the business relationship.

Control your business by having anti money laundering systems in place

C.4 MSBs must:

- put in place clear written policies and procedures relating to the prevention of money laundering and make employees aware of them; and
- ensure that any suspicious activity or transactions are properly identified and reported.

Appoint a Nominated Officer/Money Laundering Reporting Officer (MLRO)

C.5 This is a critical role within an MSB and should be performed by a suitably senior person. The main roles of the nominated officer should be to:

- establish the necessary procedures to implement the requirements of the Regulations;
- receive and review reports of possible money laundering from others involved in the business;
- decide whether to report to the Serious Organised Crime Agency.

Train your staff

C.6 All managers and anyone involved in the business who deals with customers must be trained to be aware of:

- the law regarding money laundering offences;
- business policies and procedures relating to the prevention of money laundering;
- identification and know your customer procedures;
- recognition of suspicious activity and handling of transactions which may be related to money laundering;
- internal reporting;
- record keeping.

C.7 Staff should be trained regularly on this subject and training should be repeated at least every two years.

Know Your Customer measures

C.8 MSBs need to establish the identity of customers:

- with whom they are engaged in a business relationship;
- who make a total cash payment equivalent to €15,000 or more in either a single transaction or series of linked transactions;
- where there is any suspicion that the transaction involves money laundering or terrorist financing.

C.9 Establishing identity requires firms to be satisfied that your customer is who they claim to be by obtaining evidence of their name and address.

C.10 In addition to establishing and confirming identity, KYC is about knowing why your customer needs to use your services. KYC is not a static, one-off requirement; it should be ongoing in to assist in spotting changes in circumstances which could indicate suspicious activity.

Hold all records for at least five years after the end of the business relationship

Customer ID

C.11 Legible copies of the forms of identification presented by customers, or a record of where they can be obtained, should be retained.

C.12 Customer ID records should be kept for at least five years from the date that the relationship with the customer finishes.

Business records

C.13 Records must be kept and should include the name and address of the customer. The transaction details should also be kept but in many cases where invoices are retained, a cross-reference to this will be sufficient. These records should be kept for five years.

C.14 Records of reports and other correspondence with SOCA should also be retained for at least five years.

Failure to Comply

Businesses may be liable to a civil penalty up to £5,000 for failing to comply with a registration requirement.

Failing to comply with responsibilities under the Regulations could lead to either prosecution or a civil penalty.

Details of the 1993 Money Laundering Regulations in full can be found at http://www.opsi.gov.uk/si/si2003/20033075.htm

THE PROCEEDS OF CRIME ACT (POCA) 2002

C.15 The Proceeds of Crime Act 2002 contains three principal money laundering offences (covering criminal activity) and two related-money laundering offences. These offences are:

- Concealing, disguising, converting, transferring or removing (from the jurisdiction) criminal property;
- Acquisition, possession or use of proceeds of criminal activity;
- Making arrangements which facilitate the acquisition, retention, use or control of criminal property by or on behalf of another person;
- Failure to disclose (in the regulated sector), knowing or suspecting or having reasonable grounds for knowing or suspecting that another person is engaged in money laundering or terrorist financing.
- Tipping-off any person that a disclosure has been made whilst knowing or suspecting that doing so is likely to prejudice an enquiry.

C.16 A conviction for the first three offences can incur up to 14 years imprisonment and/or an unlimited fine. A conviction for the latter two offences can incur up to 5 years imprisonment and/or an unlimited fine.

THE TERRORISM ACT 2000

C.17 The Terrorism Act 2000 (as amended by the Anti-terrorism, Crime and Security Act 2001) deals with suspicion of terrorist financing. Under section 21A, firms in the regulated sector are obliged to report where there are reasonable grounds to know or suspect offences relating to terrorist financing. These offences include:

- fund-raising for the purposes of terrorism;
- using or possessing money for the purposes of terrorism;
- involvement in funding arrangements; and
- money laundering (facilitating the retention or control of money which is destined for, or is the proceeds of, terrorism).

C.18 This obligation is significantly different from that under POCA – as it does not just cover "proceeds" of crime, but all funds, regardless of their origin.

C.19 A conviction for the offence of "failing to disclose" can incur up to 5 years imprisonment and/or an unlimited fine. Any such failure to report may also give rise to the offences themselves, which carry a penalty of up to 14 years imprisonment and/or an unlimited fine.

D Fit and Proper Test: An Example from Ireland

D.1 In addition to standard personal information like name, address, date of birth, the Fit and Proper Test also requires details of:

- career history and experience;
- qualifications and professional body memberships;
- business interests;
- beneficial ownership;
- personal liability;
- bank details;
- references;
- business plan (with details of structure, activities proposed, most recent Financial Statements, detailed financial projections for first 3 years of operation following authorisation, systems and procedures used, internal controls, antimony laundering procedures, proposed MLRO, proposed charges to be levied for transactions).

D.2 It also contains some yes/no negative criteria questions that aim to enable confirmation of good character and reputation—questions relating to history of:

- criminal and civil offences or proceedings;
- financial failure (bankruptcy, liquidation, IVAs etc);
- refusal of any license or right to trade;
- investigations of misconduct or malpractice;
- history of resignations or disqualifications;
- fraud or wrongful trading;
- investigations into conduct of affairs under Companies Act 1990;
- insider trading.

E List of Stakeholders Consulted

Global Products
British Cheque Cashers Association
Atlam Financial Services Ltd
Khan Money Exchange
Sarah Taylor
DMM Securities Ltd
Haji Currency Exchange
Mays Pawnbrokers & Jewellers
Baqeri Enterprise
Darr Money Exchange
Eastern Union Ltd
Fateh Alam
Halo Financial Ltd
Great Eastern Hotel
Graphcrown Ltd
Goring Hotel
Gold Press Ltd
GMK Money Transfer
Globe Ventures Ltd
North West Money Exchange Ltd
Punjab Money Exchange Ltd
Prime Currency Exchange Ltd
P.S.Gold Exchange
Opal Transfer Ltd
MoneyLineUK
Morcesa
Brighton Coin Shop
New Universal Impex Ltd
Cash Concepts
Nirmal Ram
Teb Travel
One World Internet Café
Choice Money Transfer Ltd
Mahal Money Exchange
Mastercheque Ltd
Exchange4free Ltd
Express Group International Ltd
Tans Ex
Unigiros
Rolltex
Bangladesh Money Exchange Ltd
Kanda Precious Metals Ltd
Link FX PLC
Dawson and Sanderson
London First Accounting Services
Bean Exchange

Bee Family Finance
Mohanned Naeem Esmail Mamaniat
Ards Borough Council
Zain Travel & Services
Chaudhary Travel & Services
Intercity Money Changers Ltd
Fairways & Swinford
Dewsbury Travel
Cash 4 Cheques
Travel Today and Money Transfer
Two Star Trading
Victoria Mutual Finance Ltd
Olompic (OIMT) Ltd.
Complete Currency Ltd.
Nkem Enterprise Ltd
Citi Money Exchange Ltd
CBN London Ltd
Nicholas James
My Hotels Ltd
R.N.K. International
The Finance Warehouse Ltd
Colombo Exchange Company Ltd
The 4 Less Group
CLOUD 7
The Interchange Organisation Ltd
Moneyport Ltd
VKL Nursing And Healthcare Services Ltd
Zamax Money Transfers
Nicer Links Money Transfers
Anra UK LTD
Swift Cash Money Transfer
Ardfert Trading Ltd
One Money Mail Ltd
Value Finance Corporation Ltd
Matrix International Holdings
Metro Remittance (UK) Ltd
Midlands Co-operative Society Ltd
Jamaica National Overseas UK Ltd
Jensley Ltd
A Mehta
Global Link Communications
Corus Hotels Plc
Dahabshiil Transfer Services Ltd
Lomondo Ltd
Eri Financial and Business Solutions
M&J Enterprises

Girar UK LTD
South Cheshire Enterprises Ltd
Flywell Services UK Ltd
Earthport Plc
Firmdale Hotels PLC
Federal Exchange
Eurolink Investments
Sterling Exchange (UK) Ltd
Easy Exchange.co.uk
Ans Travel Ltd
BS Aujia
Smith Cole Financial Limited
UAE Exchange Centre LLC
SM Travel Services
Sarhad Money Exchange
Thistle Hotels Ltd
The Money Exchange
N& N Pawnbrokers
United Coop Travel Group
Galactica Links Ltd
Trans Opt
Enfield Exchange
Eastern Money Transmitter
Amal Exchange
ClearACheque Ltd
Capital Currencies Ltd
Anglo Asian Mint Mart Ltd
Mamood Ali
NPC Remittances Ltd
City Pledge
Hexagon Partners Ltd
J&M Gildea Bureau Services
Moon Star Travel
Stopbong Ltd
Metro Multi Services
Swift Cash Ltd
The Edinburgh Woollen Mill
Xpress Money Services Limited
K&M Cash Booth
Cookson Finance
UK Money Exchange
Legal Money Exchange
Universal Currency FX
LTB LtdSeven Day Company
A1 Travel Services

Euramerica Financial Link Limited
Bestway Exchange Limited
Victoria Mutual Finance Ltd
TG Worldwide Money Transfer Ltd
G&J Geddis Ltd
Khyber International
Tor Currency Exchange Ltd
Garstang Travel
Fraser Eagle Worldchoice Ltd
UK International Money Transfer
Zafar Kish Exchange
Money Transfer International (UK) Ltd
Zak Money Exchange Ltd
Woolwich Services Ltd
Swift Transfers Ltd
Dollar East Ltd
Doctors FX
Delta Universal
DCE PLC
Smart Currency Exchange Ltd
Remittance2Pakistan.com
Taka Exchange UK Ltd
Senli Cash & Go
Cosmas Money Swift Ltd
Global Currency Solutions
Corporate FX Ltd
RIA Financial Services
Reusch International Ltd
Western UK Marriott
Rahman Association
Insaf Exchange
Inara Transfers Ltd
IMTS Ltd
Ideal FX
Highstar Technical Ltd
Harvey World travel

Sharq Ltd
Ahmed Exchange
Monexpress
The Xchange Business
TransFast London
ICT Direct
A.F.A. Pinion
Yasin MSB Ltd
City Inn Glasgow
Kayem Travel
Hafiz Bros Travel & Money Transfer
Sahloul & Kamar Trading Ltd
E.T.A Remittance
Safe Transfer Ltd
Solapace Ltd
Sohail Money Exchange
TTT Moneycorp Ltd
Rishi Exchange
Danubius Hotel Regents Park
Thomas Exchange Ltd
Daily Fastlink
Credit Lucky Ltd
Raffles Exchange Ltd
Jamiaca National Overseas UK Ltd
Iremit Global Remittance UK
Robert Claire & Co Ltd
World First
International Currency Network
Resolution Travel Ltd
PSA Transport Ltd
Polang Ltd
PJ Money Transfer
Pars Exchange
Persia Exchange
World Link Money Transfer

Made2Serve
F Peyman - Fard
Money Express Financial Ltd
Millennium & Copthorne Hotels
Killyhelvin Hotel
Ashburn Hotel
The Original Travel House Ltd
Swift Cash Money Transfer
Sultana Sarees
Senvia Money Services
Sangerwal Money Transfer Services
Mr P Burke
Sahan express ltd
Transfast Services
Rupali Exchange UK Ltd
Royal Remittance
Riverboat Hotel Operator
Saleem MSB
Overseas Express
Rational Foreign Exchange Ltd
Rahman Associates Money Transfer
Roundworld Trading Ltd
Global Exchange Ltd
Travel Direct & ME Ltd
Amana Express
International Money Exp Ltd
Intercash (Croydon) Ltd
Ommex
Inter Transfer
Worldwide Currencies Ltd
Worldchoice Travel
Wall Street Forex London Ltd
Jaff Service Ltd
KK Travel & Money Transfer
WA International Ltd

F

Glossary of Acronyms and Technical Language

- 1993 MLRs: The 1993 UK Money Laundering Regulations (implementing the First EC Money Laundering Directive) http://www.opsi.gov.uk/si/si1993/Uksi_19931933_en_1.htm
- 2001 MLRs: The 2001 UK Money Laundering Regulations (amending the First EC Money Laundering Directive). http://www.opsi.gov.uk/si/si2001/20013641.htm
- 2003 MLRs: The 2003 UK Money Laundering Regulations (implementing the Second EC Money Laundering Directive). http://www.opsi.gov.uk/si/si2003/20033075.htm
- 2007 MLRs: The 2007 UK Money Laundering Regulations (implementing the Third EC Money Laundering Directive)—implementation details still being negotiated and consulted upon.
- Agent: An agent is a third party who provides money services on behalf of a principal. Whether or not you are an agent depends on the agreement made with the principal in question—some agents work on an arms length basis and so need to register independently.
- Bank of England consolidated sanctions list: It is a criminal offence to make funds available to or for the benefit of individuals or organisations subject to financial sanctions or to a person acting on their behalf. A consolidated list of all to whom financial sanctions apply is maintained by the Bank of England, and firms are required to notify the Bank of England if they have had any dealings with a listed person or a person acting on his or her behalf.
- Better Regulation Principles: All government policy proposals should meet the five Principles of Good Regulation, devised by the Better Regulation Task Force (an independent body set up by government to advise on regulatory issues). These are:
  - proportionate - to the risk
  - accountable - to ministers and Parliament, to users and the public
  - consistent - predictable, so that people know where they stand
  - transparent - open, simple and user-friendly
  - targeted - focused on the problem, with minimal side effects
  - http://www.cabinetoffice.gov.uk/regulation/ria/overview/index.asp for details.
- CATCH: The guidance to the industry on following the MLRs outlines requirements for compliance using the acronym CATCH:
  - Control your business by having anti money laundering systems in place
  - Appoint a Money Laundering Reporting Officer (MLRO)

  - Train your staff
  - Know Your Customer (KYC) measures
  - Hold all records for at least five years after the end of the business relationship.

- CCJs: County Court Judgement. An order of Court against a debtor to pay an outstanding debt and bill.
- Conduct of Business requirements: Conduct of business principles can be defined as those principles of conduct which govern the activities of those who provide financial services and which have the objective of protecting the interests of their customers and the integrity of the markets. These principles are distinct from financial adequacy principles designed to ensure market security. In fact, the two sets of principles complement each other to promote the confidence of investors and the smooth operation of the market.
- De minimis: is a Latin expression meaning about minimal things. In the case of money laundering risk-assessment, a de minimis limit is a limit above which a particular action must be taken, and below which a risk-assessment is made before deciding whether or not the action is required. Some businesses choose to specify de minimis limits as part of their wider risk management policies. Critically, a risk-based approach to the particular activity—whether it is verifying identity or submitting a disclosure—must be taken for transactions under the limit too.
- EU Wire Transfers Regulation is coming into force in January 2007. It will require all transfers remitted to destinations outside the EU to have the identification of the sender verified and originator information (name, address or date and place of birth, account number or unique identifier for non-account based transactions) to be sent along with the payment. Within the EU, verification documents will need to kept for 5 years and produced within 3 days upon request. See annex B or [link to HMT website condoc] for more details.
- FATF: FATF stands for the Financial Action Task Force on Money Laundering which was established by the Group of Seven Nations summit in Paris in July 1989 to examine methods to combat money laundering. The primary policies issued by the FATF are the Forty Recommendations on money laundering and the Special Recommendations on Terrorist Financing. Together, the Forty Recommendation and Special Recommendations on Terrorist Financing set the international standard for anti-money laundering measures and combating the financing of terrorism. Both sets of FATF Recommendations are intended to be implemented at the national level through legislation and other legally binding measures.
- Financial Intelligence Unit: the national central unit/authority as recommended by the FATF, which receives analyses and acts upon suspicious activity reports and deals with AML matters.
- Front companies: Normally a company that is a front for organized crime or other illegal activities.

- FSA: The Financial Services Authority (FSA) the independent body that regulates the financial services industry in the UK. The FSA have been given a wide range of rule-making, investigatory and enforcement powers in order to promote efficient, orderly and fair markets and to help retail consumers achieve a fair deal.

- "Gold-plating": Gold-plating refers to the practise of national bodies exceeding the terms of European Community directives when implementing them into national law

- Hampton Review: In Budget 2004 the Chancellor asked Philip Hampton to lead a review into regulatory inspection and enforcement with a view to reducing the administrative cost of regulation to the mimimum consistent with maintaining the UK's excellent regulatory outcomes. See website for details of conclusions:
http://www.hm-treasury.gov.uk/media/A63/EF/bud05hamptonv1.pdf

- HMCE: Her Majesty's Customs and Excise, now part of HMRC.

- HMRC: Her Majesty's Revenue and Customs (HMRC), the organising formed through the merger of HMCE and the Inland Revenue. www.hmrc.gov.uk

- IVA: Individual Voluntary Arangements are a formal alternative for individuals wishing to avoid petitioning for their own bankruptcy.

- IVTS: Informal Value Transfer Systems. An informal value transfer system (IVTS) refers to any system, mechanism, or network of people that receives money for the purpose of making the funds or an equivalent value payable to a third party in another geographic location, whether or not in the same form. Informal value transfers generally take place outside of the conventional banking system through non-bank financial institutions or other business entities whose primary business activity may not be the transmission of money.

- JMLSG guidance: The Joint Money Laundering Steering Group is made up of the leading UK Trade Associations in the Financial Services Industry. Its aim is to promulgate good practice in countering money laundering and to give practical assistance in interpreting the UK Money Laundering Regulations. This is primarily achieved by the publication of Guidance Notes.

- KYC: "Know Your Customer" measures undertaken by the MSB sector—see Annex C for more detail on this.

- MDGs: Millennium Development Goals A set of eight international development goals for 2015, adopted by the international community in the UN Millennium Declaration in September 2000, and endorsed by IMF, World Bank and OECD. See http://www.dfid.gov.uk/mdg/ for more details.

- MLRO: Money Laundering Reporting Officer—see Annex C for more detail on this

- MLRs: UK money laundering regulations

- NCIS: The National Criminal Intelligence Service (NCIS) was set up as a separate body in April 1992 to centralise the gathering and distribution of intelligence on serious and organised criminal matters. NCIS was formed out of the National Drugs Intelligence Unit in the Home Office. Following the Police and Criminal Justice Act 2001, NCIS returned to direct funding by the Home Office in 2002 and was a non-departmental public body. On 1 April 2006 it was merged into the newly created Serious Organised Crime Agency.

- Official Development Assistance: Official development assistance is defined as those flows to developing countries and multilateral institutions provided by official agencies or by their executive agencies, which meet the following tests: a). it is administered with the promotion of the economic development and welfare of developing countries as its main objective; and b). it is concessional in character and conveys a grant element of at least 25 per cent.

- Partial RIA: (Partial Regulatory Impact Assessment). An RIA is a framework for analysis of the likely impacts of a policy change. The RIA is a key tool in delivering better regulation. This supports the government's aim of only regulating when necessary and, when it is, to do so in a way that is proportionate to the risk being addressed, and to deregulate and simplify wherever possible. Partial RIAs are performed in the early stages of policy development, at consultation stage. See http://www.cabinetoffice.gov.uk/regulation/ for more details.

- PAYE/Pay As You Earn: is a payroll deduction system in which tax is deducted from a person's income when paid by the employer. The amount withheld is determined by a tax code which applies the taxpayer's individual tax liabilities. The PAYE system is also used to collect national insurance contributions.

- PoCA: Proceeds of Crime Act 2002, POCA established many changes to the legislation, including introducing an obligation to report if there is “reasonable grounds” to know or suspect an offence has been committed. http://www.opsi.gov.uk/acts/acts2002/20020029.htm

- Principal: the trader has control over the way that business is conducted and does not act through a third party to provide money services.

- PSD/NLF: The EU Directive on New Legal Framework for Payments—sometimes referred to as the Payment Services Directive. See Annex C for more.

- Rehabilitation of Offenders Act (Exceptions) Order: The ROA Exceptions Order sets out the range of posts involving a particular level of trust whereby the legal protection offered by the ROA to ex-offenders is not available. These posts include work with children, work with vulnerable adults, and employment involving the administration of justice, national security and financial services. In respect of these posts, the regulator is entitled to know about all previous convictions, both spent and unspent.

- SARs: Suspicious activity reports. The reports are submitted by financial institutions and other bodies subject to AML regulations to SOCA when suspicious money laundering activity is suspected.

- Smurfing: A technique used in the placement of funds that are being laundered, where the funds are divided into smaller amounts so that such amounts will fall bellow the threshold at which the relevant financial institution (or other body) is required to file a suspicious transaction report.

- SOCA: The Serious Organised Crime Agency is an executive non-departmental public body sponsored by, but operationally independent from, the Home Office. SOCA formally came into being on 1 April 2006 following a merger of the National Crime Squad, the National Criminal Intelligence Service, the investigative and intelligence sections of HM Customs and Excise on serious drug trafficking, and the Immigration Service's responsibilities for organised immigration crime.

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